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The end of the Celtic Tiger: an Irish case study on the failure of corporate governance and company law

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Abstract

This article considers the effect, if any, that company law and corporate governance law[1] *had on the phenomenon of excessive lending and borrowing that occurred in the Irish economy towards the end of the Celtic Tiger era (1990–2008). The final years of the Celtic Tiger period saw the growth and collapse of the Irish property bubble, fuelled by lending of 'cheap' money by Irish banks and borrowing by indigenous Irish property development companies. This chain of events culminated in a state guarantee and bailout of the Irish banking sector which has led to ongoing significant damage to Ireland and its economy, the full consequences of which are continuing to be manifest. What is clear is that excessive risktaking by banks, as lenders, and property development companies, as borrowers, led to the collapse of both sectors.*[2] *The Irish property bubble, and this pattern of behaviour that caused it, is used here as a case study to raise questions as to why corporate governance law and company law seem to have failed to curtail such risktaking during this period. In describing these events from a legal perspective, the paper hypothesises that the failure of law can be explained by considering the inter-relationship between law and non-legal norms, the latter seeming to be more powerful and to have the ability to trump the rule of law in certain circumstances and contexts. This analysis of the role of non-legal norms is not intended to suggest that legal frameworks do not matter, but more to illustrate that, where they have failed to deliver stated goals, other factors must be understood so that the law can address the causes and drivers of this failure.*

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1 Marc T Moore, *Corporate Governance in the Shadow of the State* (Hart 2013) 3, 62–65, 65ff, refers to a distinction between the two areas of corporate governance and company law. In this author's view, corporate governance and company law are intertwined with perhaps the latter being a subset of the former. The breadth of scholarship in the corporate governance arena, emanating from political theorists, economists and lawyers, contains within it a disagreement as to its parameters. Authors such as Moore favour a narrow conception of corporate governance, others favour a broader definition. Company law sits within this broader framework.

2 Whilst in hindsight the level of risk was clearly excessive, as described in various reports to date (see n 3 below) and adumbrated by the current Banking Inquiry being conducted by the Oireachtas (see <www.oireachtas.ie/inquiries/banking>), this article does not seek to pre-empt or predict any questions regarding culpability in this regard. See generally I Lynch Fannon and G N Murphy for a discussion of such standards in *Corporate Insolvency and Rescue* (Bloomsbury Professional 2012) chs 10 and 11. The US litigation involving Citigroup is also interesting on this question: *Re Citigroup Inc Shareholder Derivative Litigation* 964 A 2d 106 (Del Ch 2009).

Introduction

Three distinct questions generated by the Irish crisis are identified in this article.[3] First, issues concerning failure of sectoral regulation, particularly regarding the financial services and banking sector are of interest. This particular aspect of the crisis seems to be a reflection of what went wrong generally in other economies.[4] The focus of this article is on company law and corporate governance law only. It is not intended to explore the regulation of financial services in any great detail.

Nevertheless, the legal framework generally is driven by a particular set of assumptions made at a level of political or legal theory and this article seeks to describe and locate Ireland within such a framework. In doing so, it hopes to highlight issues concerning ineffective use of legal rules, particularly in the corporate law field.[5]

Second, the internal governance of both the privately held property-development company (as borrower) and the multinational stock exchange-listed Irish bank (as lender) is of interest. Corporate governance is concerned with accountability which can be delivered through internal governance mechanisms determined by a corporate law framework, coupled with voluntary codes of self-regulation and, in some cases, through externally driven public law enforcement of management obligations. None represented a significant force in preventing the crisis. The question is why not?

Finally, this article proposes that some key aspects of failure of legal constraint can only be understood with reference to 'non-legal norm' scholarship.[6] In considering the failure of law in this broader context, this article considers the Irish crisis and the failure of corporate law and corporate governance law through the prism of non-legal norm scholarship, which is of continuing interest to this author.

Part 1 of the article briefly describes the development of the Irish economy from 1990 to 2006 and the growth of the Celtic Tiger. It also describes the growth of a significant property bubble in Ireland from around 2002, fuelled by lending from Irish banks to indigenous property-development companies, to its ultimate collapse in 2008, the latter triggered by a global financial crisis. This bursting of the property bubble led to catastrophic effects in the Irish banking sector which, in turn, were addressed by a state bank guarantee

3 *The Irish Banking Crisis: Regulatory and Financial Stability Policy 2003–2008* (Honohan report) (May 2010); Klaus Regling and Max Watson, *A Preliminary Report on the Sources of Ireland's Banking Crisis* (May 2010); Peter Nyberg, *Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland*, report of the Commission of Investigation into the Banking Sector in Ireland (Nyberg report) (March 2011).

4 John C Coffee, 'What Went Wrong? A Tragedy in Three Acts' (2009) 6 University of St Thomas Law Journal 403. See also John C Coffee, 'What Went Wrong? An Initial Enquiry into the Causes of the 2008 Financial Crisis' (2009) Journal of Corporate Law Studies 1. For a description of the regulatory context in which financial services and the banking sector operated in Ireland, see generally Mary Donnelly, *The Law of Credit and Security* (Thomson Reuters Professional 2011), in particular chs 1 and 2, which refer extensively to the various government and official reports on this matter.

5 For further consideration of the Irish crisis in the context of financial regulation and the regulation of financial service institutions generally, see Blanaid Clarke and Niamh Hardiman, 'Hubris and Nemesis in Ireland' in Sue Konzelmann and M Fovargue-Davies (eds), *Banking Systems in the Crisis: The Faces of Liberal Capitalism* (Routledge 2012).

6 See generally *Norms and Corporate Law Symposium* (2001) 149 University of Pennsylvania Law Review 1.

and bailout.[7] Part 2 will describe how Ireland placed itself both legally and politically as a small open economy during the years of spectacular economic growth and how the consequent development of a particular regulatory approach contributed to the crisis. Many commentators have considered the failure of regulatory action in relation to banking and financial matters.[8] The manner in which legal frameworks are developed, but also enforced, is reflective of a political context and it is interesting to see how theoretical debates affected the development of a legal and regulatory approach in Ireland. Part 3 will focus on company law and corporate governance law and what seems to be a failure of an apparently sophisticated legislative framework to address, or indeed prevent, an event of such cataclysmic proportions. Because of the similarity of Irish company law to company laws of other common law countries, this part will present Ireland as a case study to explore questions which, it is hoped, are relevant to company lawyers from many jurisdictions about the proper functioning of company law in the face of powerful forces which can be described from a norm scholarship perspective. Part 4 will raise some questions about the inter-relationship between law and non-legal norms. The central question is, therefore, about the effectiveness of corporate governance scholarship in the decades preceding the financial crisis, particularly that scholarship emanating from a law and economics disciplinary background. It would seem that, regardless of the expertise of those writing in this field, corporate governance failed its biggest challenge. Similarly, the effectiveness of company law is also a matter for concern. The final part attempts some simple propositions as a conclusion.

1 From growth to bubble 1990–2006

In considering the development of the Irish economy from 1990 during the following two decades, a distinction can be made between the first part of this account, which describes the birth and growth of the Celtic Tiger economy, and the second part, which describes the development of the property bubble and the ultimate collapse of the economy in 2008. This provides an important context to my claim regarding norms and the law's failure to prevent excessive risktaking.

Act one: Ireland's economic boom and Growth: the 'true Celtic Tiger' years[9]

Ireland's overall economic success in the period from 1996–2004, or possibly 2006, was certainly historically significant. The average growth rate in gross domestic product (GDP) in Ireland between 1996 to 2000 was about 9 per cent year on year, with the year 2000 showing a decline in the figures but still showing an average growth figure of around 4 per cent from 2000 to 2005.

Significantly, Ireland demonstrated exceedingly low unemployment figures in comparative European terms during this period. Before this time, during the 1980s and

7 See further John Armour, 'Making Bank Resolution Credible' (2014) ECGI Working Paper Series in Law, Working Paper No 244/2014 (*Oxford Handbook of Financial Regulation* (OUP 2015 forthcoming)), where the author lists in note 6 the US 'crisis banks', which include Citigroup, AIG, Bank of America, Lehman Brothers, Bear Stearns, Merrill Lynch, Goldman Sachs, Morgan Stanley, Wachovia and Washington Mutual. Three solutions to these bank failures are described and the author refers to those which were allowed to fail, those which merged to avoid failure, or those which received special emergency assistance. In Europe the focus was on banks in particular states: Portugal, Italy, and most specifically Greece, Ireland and Spain <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2393998> accessed 20 July 2014.

8 See nn 3, 4, 5 and 7 above for some examples.

9 Much of the underlying material to support this part of the paper is derived from an earlier work: I Lynch Fannon, 'The Luck of the Irish or Just Plain Old Tax and Regulatory Planning?'(2006) 1 Entrepreneurial Law Journal 1 (Ohio State Law School). See also Lynch Fannon and Murphy (n 2) ch 1.

early 1990s, Ireland's unemployment figures hovered around 18 per cent, with relatively severe regional variations. This figure fell to 4 per cent and continued to decline right up until the property/construction sector collapsed.[10] In countries such as France, Italy and Germany, the unemployment figures were in double digits for all of the period under consideration. There was no doubt that economic growth during this period was remarkable. That said, some commentators have pointed to factors which have led to a less euphoric view of the growth figures.

- One factor that is generally accepted as having contributed to economic growth is the level of foreign direct investment (FDI) into Ireland. As a result, the figures for growth in GDP do not bear an exact correlation to gross national product (GNP) figures, which are usually closely aligned. In Ireland, because of the significant repatriation of foreign profits, the differential is estimated at between 20–25 per cent.[11]
- More interestingly, the period of apparently spectacular economic growth was preceded by periods of stagnation which should not have occurred. For example, during the period 1977 to 1984 the government pursued fiscal and economic policies which are viewed as having had a damaging effect on overall economic performance.[12] In addition, Ireland's relatively poor economic performance in the 1950s and particularly in the 1960s meant that some part of this growth involved catch-up with its European neighbours, although commentators are divided as to the significance of this catch-up point. Nevertheless, this point, made primarily by historian Joe Lee, allows us to begin to understand the collective euphoria with which Irish people enjoyed the boom period. Quite simply, we had never experienced anything like it before. This fact is relevant to the role of non-legal norms, which I discuss in part 4.

According to various reports issued by respected agencies, both domestic and international, in the middle of the decade 2000–2005,[13] the short-term trajectory for this economic growth was that it was expected to continue. However, by that time others were

10 Eurostat (figures from 10 August 2006) <http://ec.europa.eu/eurostat/statistics-explained/>.

11 'The presence of a substantial foreign owned industry sector generates a substantial repatriation abroad of profits and dividends, which must be deducted in the calculation of GNP. As a consequence, on average, Ireland's GDP measure exceeds GNP by a factor of between 20–25%, which is a crude measure of the overstatement of income, or living standards for Ireland, that is inherent in use of the international standard GDP measure.': Enterprise Ireland, Ireland Economic Profile 2 (2005) <www.enterprise-ireland.com/en>. See further Organisation for Economic Co-operation and Development (OECD), *OECD Economic Surveys: Ireland* (2006) (hereinafter OECD 2006) 19–21, 41. See also A Bergin et al, 'The Irish Fiscal Crisis' (2011) 217 Economic and Social Research Institute(ESRI)/National Institute Economic Review R47–R59.

12 Brian Nolan et al, *Bust to Boom? The Irish Experience of Growth and Inequality* (Institute of Public Administration 2000); Kieran A Kennedy et al, *The Economic Development of Ireland in The Twentieth Century* (Routledge 1988) 87–90. Joseph Lee, *Ireland: Politics and Society 1912–1985* (CUP 1989).

13 'The Quarterly National Accounts for the third quarter of 2005 show GNP to have increased by 7 per cent in volume terms since the same period in the previous year . . . We believe that this strong performance will persist for the remainder of 2005 and that it will continue into 2006. For 2005, we think GNP will have grown by 5.0 per cent and that GDP will have grown by 4.8 per cent. For 2006, we forecast growth in GNP of 4.8 per cent [sic] and 4.7 per cent [sic] for GDP.': Alan Barrett et al, *Quarterly Economic Commentary, Winter 2005* (Economic and Social Research Institute January 2006) 1 <www.esri.ie/pdf/QEC2005Win_ES.pdf>. See ESRI <www.esri.ie>; Enterprise Ireland (n 11) 3; Industrial Development Authority Ireland, Ireland Vital Statistics 4–5 (2006) <www.idaireland.com> (hereinafter IDA Ireland). See also OECD 2006 (n 11) 19–21.

warning that sound economic and financial factors were being supplanted by a housing and property bubble.[14]

Act two: the growth of the property bubble – how things started to go wrong[15]

Following the period of real and significant economic growth from the late 1990s, the train started to accelerate in a way which ultimately became unmanageable. The flow of cheap capital and the pattern of lending by Irish banks developed in extraordinary ways. The willingness of property-development companies to borrow significant sums to fuel land acquisitions and property projects turned out to be breathtaking in terms of a lack of risk aversion or ordinary risk analysis. During this time, as the Honohan report states, 'real residential property prices jumped to almost four times their historic norm'.[16] Taxation policies continued to support property acquisition and speculative land transactions and, accordingly, the tax base also changed. Again as Honohan states, the tax take shifted away from traditionally reliable sources of income tax and, instead, significant gains were made in capital gains tax and stamp duties, all driven by an out-of-control property market. Accordingly, the government of the day had an immediate incentive to continue supporting the property bubble as tax revenues related to property transactions continued to grow and public spending continued to increase, affecting public sector salaries and the provision of public services in a positive manner.

A significant feature of this property bubble was that activity in the construction sector became over-focused on residential property construction and, in fact, the commercial sector did not mirror the enormous levels of activity in the residential sector at any point, perhaps an early indicator that the fundamentals were skewed.[17]

Finally, when the global financial crisis occurred, the Irish banks found themselves in considerable difficulties. In 2008, the government agreed to provide a blanket guarantee to the Irish banking sector, thus converting private debt into a sovereign debt problem of horrific proportions, leading to a significant impact on public sector finances. This had immediate consequences regarding public sector salaries and, more seriously, regarding the provision of public services in Ireland, including the public health sector, the education sector and the provision of social welfare services, with ongoing difficulties and hardship being experienced by all sectors of Irish society.

When considered in the overall European context, the figures from 2005 to those most recently available illustrate that Ireland has experienced what could only be described as a 'roller-coaster' ride in terms of GDP growth and subsequent decline, compared even with its closest European neighbours. Thus, in 2005 Ireland's GDP growth rate averaged 5 per cent for that year but in 2009, within a period of four years, the GDP rate of decline averaged -9 per cent.[18] National debt increased from 20 per cent of GDP in 2007 to 84 per cent of GDP in 2012.[19] Household indebtedness, as a percentage of gross disposable

14 'IMF Warns That House Prices May Have Risen Too High' *Irish Times* (Dublin 8 August 2003); 'Property in Ireland Overvalued' *Economist* (London 16 June 2005); OECD, *Recent House Price Developments: The Role of Fundamentals* (OECD, 2005). See also Bergin et al (n 11).

15 Honohan report (n 3).

16 Ibid 24.

17 See further Lynch Fannon and Murphy (n 2) ch 1 for additional material.

18 In the Euro 15 Zone, the figures for the same years are just under 2% growth rate in 2005 and -4% decline in 2009, showing a much less significant 'swing' than that of Ireland. In 2010 the Euro Zone 15 showed a small overall growth rate, whereas the figures were still negative for Ireland for 2010.

19 ESRI, *Report on Government Debt 2000–2012* (Autumn 2013).

income, also began to grow remarkably from 2002 and has continued to grow every year since then.[20]

Conclusion

In conclusion of this part, all of the factors which contributed to the initial period of growth persisted through the economic crisis and it would seem that the positive factors described in the first period of growth leading to what is called the 'true Celtic Tiger' period[21] are now contributing to Ireland's recovery.[22] Nevertheless, Ireland is still saddled with significant sovereign debt because of the events surrounding the bank guarantee and bailout, with significant social consequences. Accordingly, questions as to how and why this banking collapse occurred are really important. The level of growth and decline is briefly described so that we can better understand the extent to which particular policy approaches failed to respond to increasingly unwarranted risktaking. An important part of this analysis relates to the apparent irrelevance of both corporate governance scholarship and rules and company law to prevent or rectify these problems occurring within different types of companies.

At this point, the scope of this paper ought to be clarified. Although the roles of the regulators, the Financial Regulator, the Central Bank and the Department of Finance, are mentioned in passing because they are referred to in the official reports and analysis of the Irish crisis, the focus is exclusively on the question of the apparent irrelevancy of corporate governance principles and company law.

2 Regulation and theory

The immediate aftermath of the banking crash and the sovereign debt crisis was cataclysmic in its effect on Irish society. Unemployment increased to 14.7 per cent in 2012[23] and emigration returned as a particularly Irish solution to economic difficulties. Household indebtedness is still a significant problem. Unlike the public protests in Greece, the Irish reaction was different, characterised by a stoic acceptance of austerity measures in the hope that things might improve rapidly.[24] This article seeks to describe and explain the failure of law to address excessive risktaking effectively. Non-legal norms provide a way of understanding why our legal structures may have failed and so the following discussion of how regulation, law and its enforcement are shaped by political theory and discourse is an aspect of non-legal norm-based analysis which will be considered further in parts 3 and 4.

20 Peter Bacon, 'The Macro Economic Context to NAMA and the Irish Property Market' (A&L Goodbody Corporate Restructuring Summit, 29 September 2010); N Russell, B Maitre and N Donnelly, *Financial Exclusion and Over Indebtedness in Irish Households* (Department of Community, Equality and Gaeltacht Affairs/ESRI 2011). The government has introduced new legislation to deal with a personal insolvency problem, the Personal Insolvency Act 2012. Recently, the personal indebtedness problem is becoming more acute as banks progress to repossessing private homes: 'Banks Attempt to Repossess 7,000 homes' *Irish Times* (Dublin, 9 March 2015).

21 Honohan report (n 3) 21. See further Donnelly (n 4) 15–25.

22 See part 4 below. 'Data Reveals Strongest Growth Since Early 2000s' *Irish Times* (Dublin, 19 September 2014), reporting that GDP grew by 5.7% in Q1 and Q2/2014. However, as described above, the difference in Ireland between GDP and GNP is significant because of the reporting of multinational profits.

23 ESRI (n 19).

24 In November and early December 2014, protests regarding water charges had become a touchstone for general exhaustion with and resistance to austerity measures. See further Blanaid Clarke and Niamh Hardiman, 'Crisis in the Irish Banking System', UCD Working Papers in Law, Criminology and Socio-Legal Studies, Research Paper No 02/2012 now published in Konzelman and Fovargue-Davies (n 5). In this paper the authors examine the particularly Irish nature of the crisis as described in the official reports to which this paper also refers. See further part 4 below.

In a very significant speech delivered in New York in May 2012, Irish President Michael D Higgins reiterated a fundamental theme of his presidency, namely the need to refashion a new sense of Irish identity as Ireland faced the economic crisis into which it had been plunged at that time. He mentioned the concept of ethics and the ethical life a number of times in this speech and referred to the need to re-imagine a citizenry of ethical economic actors in contrast to the immediately preceding years which were dominated by greed:

> I want to, however, invoke this evening the act of remembering, not just as an act of retrieval but as a forward-looking act, as an exercise of will and of conscious choice, an essential part of the process of renewal, a recovery of such words of ethical life as might reveal an illumination of the unrealised possibilities of a future Irishness – na féidireachtaí gan teaorainn.
>
> Such a creative impulse as we need now, not only for economic recovery, but for humanity, is one that will relocate economics for example, in a moral ethical context that is scholarly, reflexive and genuinely emancipatory, an economics within a culture.[25]

With this instruction in mind, some aspects of Irish political discourse as it manifested itself during the Celtic Tiger years will be considered, in particular, in the spheres of corporate and economic activity. This discourse influenced the regulatory framework in which the decline of the Celtic Tiger took place.

Understanding capitalism

The starting point is a contrasting speech delivered by Mary Harney then TD, Minister for Enterprise and Tanaiste, regarding regulation of the Irish economy. In this speech, given in July 2000, Ms Harney[26] maintained that Ireland was closer to Boston than Berlin in its approach to economic and regulatory matters. In considering what this might mean to corporate lawyers and corporate governance scholars, this paper draws on an earlier work, a monograph entitled *Working within Two Kinds of Capitalism* which seeks to describe and explain two different understandings of corporate function and action which pertain in US and EU understandings of economic activity and corporate governance. The emphasis in that particular work was on the comparative regulation of the employment relationship within European companies compared with the lack of regulation of the same relationship in the USA. This comparison resonates with the 'Boston or Berlin' rallying cry.[27] Law and economics scholarship and its analysis of corporations begins with the 'firm theory' of Coase, moving on with Alchian and Demsetz and on to Easterbrook and Fischel.[28] In the work of the latter theorists, reliance was placed on the integrity of markets as a means of organising human and corporate affairs leading to a contractarian and liberal view of the role of corporate law and corporate governance law. In particular, reliance on the capital markets as a way of constraining corporate management was of central interest to these scholars.[29] In terms of corporate governance affairs, this contractarian paradigm was particularly dominant in US theoretical thinking throughout the 1990s and up until the

25 See www.president.ie/index.php?section=5&speech=1105&lang=eng. The president has since launched an Ethical Initiative, in April 2014.

26 See <www.djei.ie/press/2000/210700.htm>.

27 I Lynch Fannon, *Working Within Two Kinds of Capitalism* (Hart 2003).

28 F H Easterbrook and D R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991).

29 Eugene Fama, 'Agency Problems and the Theory of the Firm' (1998) 88 Journal of Political Economy 288; and 'Efficient Capital Markets' (1991) 46 Journal of Finance 1575.

recent crash.[30] It also attracted the interest of UK corporate lawyers in the immediate period preceding the enactment of the 2006 UK Companies Act.[31]

An alternative school of thought, described by Chancellor William T Allen of the Delaware court, in his remarkable analysis of corporate governance scholarship,[32] is the social model grounded 'in the dominant concepts of continental Europe and a yet earlier age'. Allen states that those holding this more communitarian view are 'more willing to regulate and define the legal institutions of property and contract in service of social values'. (The legal institutions of property will include corporations.) Regardless of whether this view, based on a communitarian legal philosophy, is more 'European' than others, although it is asserted here that it is, what is clear is that in the decades preceding the financial crisis from 1990 onwards the hegemonic, liberal contractarian view prevailed. We are still challenged in our presentation of an alternative theory of corporations.[33]

In Ireland during the Celtic Tiger years, the catchphrase adopted by the Tanaiste was often repeated, with questions constantly being asked as to whether Ireland and its citizens saw themselves as more rightly identifying with Boston rather than Berlin. Such statements, while acknowledging the underlying differences in economic and political theory, failed to articulate the significance of these distinctions in real outcomes.[34] However, in espousing a heightened sense of capitalist reform, policymakers in Ireland neglected to engage deeply with the US model which, despite its overt reliance on a neoclassical, liberal regulatory model, and although often characterised as being more liberal than the European model, nevertheless presents a heavily regulated environment at federal, state and local level. The continued debate about corporate tax is a good example of this misunderstanding.[35]

In identifying the romanticising of the conflict between Boston and Berlin, my hypothesis is that Ireland positioned itself in a particular context which fed into both a regulatory response to financial services and in an attitude (non-legal norm) to law enforcement. Ireland and the Irish became the 'uber-capitalists' of the world, displaying a remarkable distaste for and distrust of regulation. Noam Chomsky has described the

30 See Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439, for a robust assertion of the dominance of the US model. For a more balanced view, see further John Armour, Henry Hansmann and Reinier Kraakman, 'The Essential Elements of Corporate Law' in Armour et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (1st edn OUP 2004/2nd edn OUP 2009). For disagreement, see Lawrence Mitchell, *Progressive Corporate Law* (Westview Press 1996); and *Corporate Irresponsibility: America's Newest Export* (Yale University Press 2001).

31 See Moore (n 1). For an early contrary view in the UK, see Jonathan Plender, *Going off the Rails: Global Capital and the Crisis of Legitimacy* (John Wiley & Sons 2003) for a very readable consideration of the role of capital in governance structures.

32 William T Allen, 'Contracts and Communities' (1993) 50 Washington Lee and Law Review 1.

33 See David Millon and other progressive corporate law scholars writing in the USA in the early part of the millennium: David Millon, 'Communitarianism in Corporate Law: Foundations and Strategies' in Mitchell, *Progressive Corporate Law* (n 30); David Millon, 'Why is Corporate Management Obsessed with Quarterly Earnings and What Should Be Done about It?' (2002) 70 George Washington Law Review 890; Joseph W Singer, 'Jobs and Justice: Rethinking the Stakeholder Debate' (1993) 43 University of Toronto Law Journal 475; Stephen Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Ashgate 2007).

34 For example, Irish people generally welcome regulation of the employment relationship, consumer regulation and environmental protection all emanating from the EU, but there seems to be a lack of understanding of this positive effect of a European social model approach to corporate governance when it comes to other more liberal market approaches in relation to other aspects of corporate activity.

35 BBC News, 'European Tax Havens faces Obama Action' <http://news.bbc.co.uk/2/hi/business/8036914.stm> (6 May 2009). The average corporate tax rate in the USA is 39.5% compared with the Irish corporate tax rate which is 12.5%. Simon Carswell, 'Obama Names Ireland in Attack on Tax Policies of US Firms' *Irish Times* (Dublin 25 July 2014).

'American passion for de-regulation',[36] a passion that reached its zenith in the boom years of the 1990s.[37] During that same period, Ireland became more American than the Americans. The Dublin Financial Services Centre, one of the drivers of the new Irish economy, thrived on an approach to regulation which its representative association described as 'responsive regulation' in efforts to attract overseas funds business.

Ireland espoused 'light touch and responsive regulation' in the area of finance, insurance and banking in particular and low levels of corporate tax which are unheard of in most developed industrial economies. Referring to both preceding reports on the Irish crisis, the Nyberg report states:

> Both reports agree on the failure of both the FR (the Financial Regulator) and the CB (Central Bank) to foresee or prevent the financial crisis. The report by Regling & Watson, besides highlighting the importance of international developments and fiscal policy, stresses the role and activities of the FR. It was unclear to the authors what the FR knew and when, and also why the supervisory response was not more forceful. The Honohan report addresses this aspect as well, emphasising the way in which the principles-based approach to regulation was implemented. It also notes and discusses the modest policy activity of the CB despite its responsibility to promote the overall stability of the Irish financial system.[38]

However, whilst Ireland might have become the location of a particularly uber-capitalist type of regulatory framework, this resistance to regulation was not just an Irish phenomenon. In a political theory context, Sandel[39] describes the decades immediately preceding the 2008 crash as the era of market triumphalism.[40] He describes how as a result, without 'quite realising it, without even deciding to do so, we drifted from having a market economy to being a market society'. He continues:

> The great missing debate in contemporary politics is about the role and reach of markets. Do we want a market economy or a market society. What role should markets play in public life and personal relations?[41]

36 Chomsky refers to David Sanger, political analyst with the *New York Times*, as having identified this phenomenon. See Noam Chomsky, *Profit over People: Neoliberalism and the New Global Order* (Seven Stories Press 1999) 64.

37 The passing of the Sarbanes–Oxley Act was generally viewed as heralding the beginning of serious federal regulation of US corporations. Further federalisation has been resisted in the USA. See Stephen Bainbridge, 'Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition' (1995) 52 Washington and Lee Law Review 1189, reprinted in (1996) 38 Corporate Practice Commentator 1; '"The Creeping Federalization of Corporate Law" Regulation 26: Sarbanes–Oxley: Legislating in Haste, Repenting in Leisure' (2006) 2 Corporate Governance Law Review 69; 'Director v Shareholder Primacy in the Convergence Debate' (2002) 16 Transnational Lawyer 45–62. The phrase 'quack corporate governance' was used to criticise further federal regulation of corporate governance: Roberta Romano, 'The Sarbanes–Oxley Act and the Making of Quack Corporate Governance' (2005) 114 Yale Law Journal 1521, 1523. For a similar approach to European Commission regulation, see Luca Enriques and Dirk Zetzsche, 'Quack Corporate Governance, Round III? Bank Board Regulation under the New European Capital Requirement Directive' (2014) ECGI Working Paper Series 249/2014, now published in (2015) 16 *Theoretical Inquiries in Law* 211. The Capital Requirement Directive and Regulation are discussed below in relation to independent directors.

38 Nyberg report (n 3) para 1.2.4.

39 Mark Sandel, *What Money Can't Buy: The Moral Limits of Markets* (Penguin 2012).

40 Ibid 18.

41 Ibid 15.

During this same period, approaches to corporate governance and corporate law theory became similarly politicised and polarised.[42] In the USA, where such debates are particularly robust, some argued for the dominance of the Anglo-American corporate governance model, which in the views of these writers was characterised by a shareholder-oriented approach, where corporate function was to maximise shareholder wealth, free from intervention from regulatory agencies, in particular, federal regulation.[43] Legal academics in the USA and in the UK were particularly influenced by this approach and, in turn, wielded significant influence in the development of the corporate law framework. In the USA this ranged from resistance to federal regulation of securities law and other financial instruments as represented in the Sarbanes–Oxley Act[44] to resistance in the UK to further Europeanisation of the corporate law landscape.[45] Others, a minority, argued for an alternative view of corporate governance. Now some corporate governance scholars are beginning to see how this theoretical paradigm has become particularly problematic.[46]

In practical terms, this approach to regulation is certainly regarded now as a contributing factor to the failure to regulate the financial sector. In a series of reports on the international financial crisis and its causes, the failure to regulate or even to identify, through adequate supervision, certain aspects of risk management is a theme which is continually pursued, along with additional and possibly more significant macro-economic issues, such as flow of cheap capital into Europe.[47] In Ireland, regulatory failure of the banking system seems to have been particularly significant. In their report on Ireland's banking crisis, Regling and Watson state as follows:

> First, all of the . . . problems of policy analysis . . . and implementation were present in the Irish case. Second, policy problems in certain areas were unusually severe in Ireland; here, the weakness in tax policy . . . [which continued to support property market expansion] . . . and in the implementation of financial supervision must be cited. Third, Ireland was one of those cases where there were at least some instances of extremely serious breaches of corporate

42 See the discussion recently from two leading US academics decrying the politicisation of their earlier work: Ronald Gilson and Reinier Kraakman (2014) 'Market Efficiency after the Financial Crisis: It's Still a Matter of Information Costs', Stanford Law School Working Paper Series no 458 and Columbia Law School Center for Law and Economic Studies Working Paper Series no 470 at <http://ssrn.com/abstract=2396608>, in which the authors complain about the politicisation of the efficient capital markets hypothesis.

43 Such writers included Henry Hansmann and Reinier Kraakman, see, for example, 'The End of History for Corporate Law' (n 30). See further Armour et al (n 3). Progressive corporate lawyers positing an alternative approach included Lawrence Mitchell (n 30) and Millon (n 33). These debates are described from a European perspective in Lynch Fannon (n 27); and I Lynch Fannon, 'Employees as Corporate Stakeholders: Theory and Reality in a Transatlantic Context' (2004) 27 Journal of Corporate Law Studies 155.

44 See n 37 above. See further Moore (n 1) for further description of this contractarian approach.

45 In Europe, harmonisation of European company law stalled on the need for compromise between a typically continental European approach to corporate law and corporate governance and the 'Anglo-American' approach. Compromise was so difficult to achieve that in many respects harmonisation of company law stalled during this period. See further the 2012 Action Plan for European Company Law and Corporate Governance discussed below.

46 Lynn Stout, *The Shareholder Myth* (Barrett-Koehler 2012); Colin Meyers, *Firm Commitment* (OUP 2013). See also ECGI Corporate Governance Debate, Dublin <www.ecgi.org> (May 2013). See further J Armour and J Gordon, ' Systemic Risk and Shareholder Value' (2014) Journal of Legal Analysis 35, arguing for office and director liability rules in 'systemically important financial firms' as a 'complement to (and substitute for) the prescriptive rules that have emerged from the crisis'.

47 European Commission, *Report of the High Level Group on Financial Supervision in the EU* (the de Laroisiere report) (Brussels 25 February 2009); UK Financial Services Authority, *A Regulatory Response to the Global Banking Crisis* (the Turner review) (Financial Services Authority March 2009); European Commission Committee on Capital Markets Regulation, *The Global Financial Crisis: A Plan for Regulatory Reform* (May 2009). See further Donnelly (n 4) chs 1 and 2.

> governance, going well beyond poor risk assessment, and eventually having a systemic impact.[48]

In its *Action Plan for European Company Law and Corporate Governance* published in 2012,[49] the European Commission observed: 'The financial crisis has revealed that significant weaknesses in corporate governance of financial institutions played a role in the crisis.'[50] This plan has been followed more recently by a series of measures on revision of the shareholder rights directive, a recommendation regarding 'say on pay', i.e. executive remuneration, recommendations on 'comply or explain' principles in corporate governance, and a single member companies directive.[51] All of these illustrate that weaknesses in both corporate governance and regulation of smaller companies were revealed during the crisis.

Conclusion

In conclusion to this part, there seems to be a general consensus amongst corporate governance scholars that corporate governance or more specifically 'bank governance failure' and indeed company law are not *centrally* to blame for the financial crisis. Factors such as 'lax monetary policy of the American Federal Reserve Bank, the policy and practice of credit financing the housing of broad masses of the population, the securitisation of credit . . . the failure of rating agencies as well as of the regulators and supervisors'[52] were all really important external factors. Yet, when faced with these external factors, which presented significant challenges in terms of risk management, there seems to have been a considerable failure, despite the apparent sophistication of corporate governance and corporate law theory.

For company law and corporate governance scholarship, the danger is clear – it is is one of irrelevancy.

3 The role of company law

As the hypothesis is developed that the espousal of a contractarian, neoliberal paradigm pervaded banking and financial services regulation in Ireland, the truth is that, when we actually focus on the development of company law in the same period in Ireland, things take on a very different character. From 1990 to 2001, in particular, Irish company law continued to develop along lines which are very similar to the developments that took place in the UK and in other parts of the common law world during that time, although indeed the framework is less liberal than the UK.[53] The Companies Acts of the 1990s modernised Irish law and, significantly, a new piece of legislation – the Company Law Enforcement Act 2001 – increased the public law regulation of directors, shadow directors and other officers

48 Regling and Watson (n 3) 44. See also Honohan report (n 3).

49 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions COM (2012) 740 final <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52012DC0740.

50 Ibid 3.

51 European Commission Press Release, Brussels 9 April 2014. See also the Shareholder Rights Directive 2007/36/EC.

52 Klaus Hopt, 'Corporate Governance of Banks and Other Financial Institutions after the Financial Crisis' (2013) 23 Journal of Corporate Law Studies 219 and 238; Joseph A McCahery and Eric P Vermeulen, 'The Ignored Third Dimension of Corporate Governance' (2014) ECGI Working Paper Series, Working Paper no 255/2014, in which the authors argue that particular corporate forms contributed to short-termism as expressed in the financial capital markets, which in turn exacerbated competitive lending. See also Conference on New Legal Thinking in Financial Regulation, Cambridge University, 29–30 November 2013.

53 Note that, in the UK, the development of certain provisions of the Enterprise Act 2002 and the Companies Act 2006 represent a shift to a more liberal market paradigm which never took place in Ireland in terms of legal development.

of the company in relation to a whole range of directorial behaviours and misbehaviours. A new enforcement unit, the Office of the Director of Corporate Enforcement,[54] was established. In addition, an increased awareness of the importance of company law and corporate law compliance resulted in significant regulatory outreach, not only from the new Office of the Director of Corporate Enforcement but also from the Companies Registration Office. This legislation also established a public body whose function was to keep Irish company law under review.[55] In particular, the Director of Corporate Enforcement was given increased powers of supervision and enforcement, including director disqualification provisions, along the same lines as the UK Company Directors Disqualification Act 1986.[56]

And so, we are left at this point with very challenging questions as to the relevance of company law principles to the decisions which were made within the relevant companies in the period leading up to the crisis.

Economic catastrophe: the role of company law and corporate governance

The dissonance between the sophisticated legal framework in which Irish companies operated, on a par with any other developed common law jurisdiction, and the outcomes, particularly leading up to the crisis in 2008 and its aftermath, is particularly marked. The framework in Ireland is similar to UK company law and, of course, is influenced by European regulation, as is the case with all member states of the EU.

There are two areas of company law that are particularly pertinent. First are rules which affect the internal relationship between shareholders and management, as the latter continued to take risks which affected the sustainable growth of the companies in question. This applies to both the borrowers and lenders. The question here is whether shareholders were aware of or concerned by excessive risktaking and, if not, why not? The question then is whether, if any shareholder wished to proactively prevent such risktaking, were there provisions which they could have used? Additionally, are there effective provisions which could retrospectively render management accountable for such risktaking? A second area of company law that is pertinent is the body of rules which seeks to constrain excessive risktaking by management; provisions relating to reckless trading or breaches of duties in terms of skill and care might be relevant here, in addition to issues surrounding conflicts which might have compromised the desired independence of directors or board members.[57]

The failure of company law to address aspects of the crisis which could have been addressed if company law and corporate governance rules were fully utilised is fascinating. Up until the 1990s, the use of the corporate form in Ireland had been bedevilled by a failure of engagement with corporate regulation. Even as late as 1998, the McDowell report stated that 60 per cent of Irish registered companies were non-compliant with even basic requirements to return a register of shareholders, directors and a basic form of audited

54 See <www.odce.ie>.

55 See <www.cro.ie> and see also the Company Law Review Group <www.clrg.ie>.

56 For a general discussion of the development of Irish company law between 1990 and 2013, see Lynch Fannon and Murphy (n 2) ch 1.

57 S Le Mire and G Gilligan, 'Independence and Independent Company Law Directors' (2013) Journal of Corporate Law Studies 443; M Gutierrez and M Saez, 'Deconstructing Independent Directors' (2013) 1 Journal of Corporate Law Studies 63. See further the discussion of the EU Capital Requirement Directive below under the heading 'Independent directors'; Joan Loughrey, *Directors Duties and Shareholder Litigation in the Wake of the Finanical Crisis* (Edward Elgar 2012).

accounts. However, the reforms which have been described in the previous section were designed to address these faults and, for the most part, in the general scheme of things they worked.[58] The property sector in Celtic Tiger Ireland seems to have been an exceptional case.

The small 'corner shop': the borrowers

Many of the dominant Irish property-development companies were private companies, not listed on the stock exchange (Irish, English or New York) and often operated as subsidiaries of a holding company with unlimited status in sophisticated group structures. (The adoption of an unlimited company as a parent company or holding company of a group of companies is designed to reduce disclosure requirements in relation to the financial affairs of the group as a whole.) The possibilities of public regulation through the operation of stock market rules, characterised as a type of public law dimension, was therefore limited, as was the nature of information available to shareholders and others under disclosure rules.

Typical of this kind of company was the fact that one person, or one family, was identified with the company, for example, Liam Carroll and Zoe Developments, a group of companies with an unlimited parent company, Vantive Holdings, the demise of which is discussed below. This unlimited company had three shareholders, Liam Carroll and two others who had worked with him from the beginning. Another property developer, Paddy McKillen, operated through a company called Dellway Investments. McKillen was also the majority shareholder in this company. Bernard McNamara was another example of a property developer who dominated a group of companies, as was Sean Quinn of the Quinn Group, a corporate group which was originally involved in insurance but became exposed, not only to the property sector, but also to the banking sector as a shareholder in Anglo Irish Bank. This fact is unusual given the size and value of economic activity represented by these companies. On the other hand, these companies or corporate groups experienced rapid expansion and were not companies which had grown gradually over time or, as with many family companies, over generations. A common characteristic was that they were all dominated by one person, as reflected in public discussion on the individuals mentioned above. What seems to have been completely absent is the possibility of a shareholder or shareholding group exercising what in corporate governance terms is described as a 'countervailing power'. The same is true of the McInerney Homes Group, a more established Irish construction company which had been building residential properties since the 1970s. The liquidation of this company is also considered below.

The 'multinational corporation': the banks as lenders

On the other side of the negotiating table were the Irish banks, led in the first instance by Anglo Irish Bank, now the Irish Bank Resolution Corporation (IBRC) which is now in liquidation. Seeing the pace of lending taken by this bank, other more traditional Irish banks with significant retail banking engagement throughout Ireland and in other countries followed suit. These included two pillars of Irish banking, Allied Irish Banks plc (AIB) and Bank of Ireland.

As this paper is considering the internal governance of the banks and not the externally driven regulation of banking practices, it is important to mention that the two major banks – AIB and Bank of Ireland – were quoted on the Irish, English and New York stock exchanges. Throughout most of the period of the Celtic Tiger, very healthy share prices satisfied shareholders and left no real chance that any shareholder activism would have occured if concerns were to grow about the risks being taken. The faith which some

58 See generally Thomas B Courtney, *Company Law* (3rd edn Bloomsbury Professional 2011). See also Lynch Fannon and Murphy (n 2).

corporate governance scholars have in capital markets as a governance tool must now be shaken when it has become so clear that the capital markets simply reflect a very narrow measure of corporate success.[59]

The Irish banks would also have had sophisticated internal governance models, with the creation of boards with independent directors and with the chief executive officer's and chair's roles divided. A separate Financial Regulator operated in this particular regulatory space and the public law enforcement role of the Office of the Director of Corporate Enforcement could also have come into play. Nevertheless, it would seem that spectacular failures of internal and external controls regarding monitoring of risks in banking and construction sectors all occurred, leading to the current Irish crisis. This section will now consider a number of important corporate governance devices which one would expect to operate in an *ex ante* fashion.

Corporate governance: independent directors[60]

In relation to the operation of the boards of the multinational banks, the role of independent directors provides food for thought because it affected the banking crisis generally. Independent directors were considered to be a cornerstone of developed corporate governance models in the years preceding the crisis. The Cadbury report[61] emphasised the importance of the independent director. However, various scholars have questioned the importance of independent directors in light of what has happened:

> While having independent directors seems a general trend, two cautionary remarks are necessary. First, the fact that independent directors are required is of relatively little relevance by itself; what is decisive are the criteria for independence and who determines whether a non-executive director should be considered independent. Second, the effectiveness of having independent directors has not yet been empirically established.[62]

Post-crisis, the Walker review in the UK[63] made a number of recommendations on independent directors, adding to those already made in the Cadbury report. In particular, the Walker review noted that greater emphasis should be given to ensuring that the total composition of a board should represent the correct mix of financial industry capability and high-level experience in other businesses. In effect, it was acknowledged that the move towards identifying independent directors also meant there was a loss of industry capacity.

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59 See Gilson and Kraakman (n 42). The fact that this kind of competitiveness was driven by share price is mentioned in the EU Commission documents referred to above. See also the Nyberg report (n 3). See also Blanaid Clarke, 'Where Was the "Market for Corporate Control" When We Needed It?' in W Sun (ed), *Corporate Governance and the Global Financial Crisis: International Perspectives* (CUP 2011).

60 For an excellent consideration of the role of directors in Irish company law, see Deirdre Ahern, *Directors' Duties: Law and Practice* (Roundhall 2009); 'Legislating for the Duty on Directors to Avoid Conflict of Interest and Secret Profits: The Devil in the Detail' (2011) 46 Irish Jurist 82; 'Guiding Principles for Directorial Conflicts of Interests: *Re Allied Business and Financial Consultants Ltd: O'Donnell v Shanahan*' (2011) 74 Modern Law Review 596–607.

61 Sir Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (Cadbury report 1992); for the Australian position, see S J Gray, 'Corporate Governance and Board Composition: Diversity and Independence of Australian Boards' (2007) 15(2) Corporate Governance 194. Le Mire and Gilligan (n 57); Gutierrez and Saez (n 57), in which the authors argue that voluntary regulations on directorial independence are a substitute for state action in the legislative arena.

62 See Klaus Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) 59 American Journal of Comparative Law 1/(2011) ECGI–Law Working Paper No 170/2011 <http://ssrn.com/abstract=1713750>. See further K Hopt et al (eds), *Corporate Governance* (OUP 1998). This author contributed a survey on Ireland in preparation for this collection.

63 Sir D Walker, *A Review of Corporate Governance in UK Banks and Other Financial Entities* (Walker review 2009).

The point made here is that, despite considerable attention given to corporate governance policies and principles in the two decades before the crisis and despite the identification of independent directors as being an effective element of corporate governance, the financial crisis belies the faith placed in this kind of director. Post-crisis reports such as Walker have tried to effect a rebalancing of the role of independent directors. Other commentators have sought to improve on independent directors as an effective corporate governance device by exploring future possibilities for such directors.[64] The EU Commission has focused on independence of mind, reflected in the introduction of specific requirements on directors in the EU Capital Requirements Directive[65] and the EU Capital Requirements Regulation, the latter now part of Irish law.[66]

Some scepticism about the effectiveness of *principles* or 'soft law' initiatives, such as independent directors, as substitutes for regulation is warranted. It is noteworthy that, despite various recommendations on criteria and restraints for independent directors in the USA, UK and Australia, there is no constraint on the holding of stock options in any of these corporate governance codes.[67] It is argued here that, without a prohibition on directors holding stock options, independence will always be compromised.

Corporate governance: shareholders as a countervailing power[68]

The shareholder as a 'countervailing power' in corporate governance terms is considered here in light of the dynamics which seem to have actually occurred both within the property-development companies and in the banks in relation to shareholders. Two examples of Irish property development companies illustrate the enormity of this problem. In 2008/2009 it became clear that Liam Carroll's group Zoe Developments (referred to above) was insolvent and it sought the protection of the High Court and the possibility of corporate rescue through the 'examinership' process provided for in the Companies Amendment Act 1990. Ultimately, the High Court refused an application for the examinership of the Zoe Group and the rescue of the corporate group,[69] which encompassed seven companies controlled by the developer Liam Carroll through a holding company, Vantive Holdings. These companies owned a combined debt of €1.3bn.

Interestingly, the independent accountant's report was produced by KPMG and predicted a surplus of €10m over a three to five-year period, on the assumption of a recovery in the Irish property market. In refusing the application, Kelly J stated that '[the] degree of optimism on the part of the independent accountant borders, if it does not actually trespass, upon the fanciful'.

Kelly J went on to refuse the application to appoint an examiner observing:

> I have the gravest reservations about the projections on which the independent accountant has relied in forming his opinion. They appear to me to be lacking in reality given the extraordinary collapse that has occurred and the lack of any indication of the revival of fortunes in the property market.

64 See Guiterrez and Saez (n 57).

65 Capital Requirement Directive IV (Directive 2013/36/EU Articles 76–91).

66 Capital Requirement Regulation 575/2013 Article 435, SI no 159/2014 European Union (Capital Requirements) (no 2) Regulations 2014. See Enriques and Zetzsche (n 37).

67 See the very useful survey conducted by Le Mire and Gilligan (n 57), table 2, 470.

68 See generally Paul Rose and Bernard Sharfman, 'Shareholder Activism as a Corrective Mechanism in Corporate Governance' (2014) Ohio State Public Law Working Paper no 225 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2324151>.

69 *Re Vantive Holdings* [2009] IEHC 384. See also *Re Vantive Holdings* [2009] IESC 68.

A second feature of the fate of this corporate group was that Liam Carroll, the driving force behind Zoe Developments, was hospitalised during the proceedings. In corporate governance terms, it is extraordinary that in a company of significant financial standing one individual could still be so closely and personally identified with *his* company, which at that time owed more than €1bn.[70]

The difference between previous recessionary periods in Ireland and the current situation is that in the past the banks would always have stood as independent creditors outside the corporate structure. In contrast, in this particular recession, because of the significant exposure of the Irish banks to the property sector, the banks did not enjoy an 'arms-length' relationship with the debtors – in corporate governance terms there was no 'countervailing power'. As the boom years fell to ashes, it became clear that the banks and the banking system were hopelessly compromised. As Kelly J observed:[71]

> It is sometimes said that when small or modest borrowers from banks encounter difficulties in repaying their loans, then such borrowers have a problem. For those with large borrowings, it is the banks who have a problem.

Only in the later period, when the Irish banks had effectively been brought under the control of the state, do we see Irish banks objecting to examinerships as creditors with securities to enforce at 'arms-length'.[72] This occurred in the *McInerney* case, with all the banks originally objecting to the examinership and also objecting to the proposed rescue scheme on the grounds that they would be unfairly prejudiced. McInerney Homes Ltd had been a major player in the Irish construction sector even before the Celtic Tiger era and sought the appointment of an examiner in August 2010. The appointment was opposed by a number of banks, including two banks which had been taken into state ownership, namely Bank of Ireland and Anglo Irish bank, and a third banking party, KBC Bank. In total, the company owed the banks €113m. Following the appointment of an examiner and the preparation of a scheme designed to facilitate the survival of the company, the High Court, in a series of hearings reflecting the complexity of the situation, declined to confirm a proposed rescue involving investment from a US property investor. On appeal the order was confirmed by the Supreme Court in July 2011.[73]

The complexity of the economic context cannot be underestimated. As O'Donnell J observed, delivering the majority judgment of the Supreme Court in *Re McInerney Homes Ltd*:

> This case has resulted in the somewhat surreal scenario that over a three day period this Court was occupied by teams of lawyers, accountants and assorted experts engaged in a bitter battle to gain control of an Irish property development company, united only in the apparent belief that the development of property in Ireland over the next decade would be a lucrative business . . . It might be observed that the prediction of the future development of the property market in Ireland is something that defeated policy makers and experienced developers and lending institutions over the past decade and brought the latter

70 *Re Vantive Holdings* [2009] IEHC 384. See also *Re Vantive Holdings* [2009] IESC 68.

71 Ibid.

72 See further Report of the Commission of Investigation into the Banking Sector in Ireland, *Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland* (March 2011) <www.bankinginquiry.gov.ie/Documents/Misjuding%20Risk%20-%20Causes%20of%20the%20Systemic%20Banking%20Crisis%20in%20Ireland.pdf>.

73 There were four separate hearings in the High Court in this case: the first judgment in January 2011 refusing confirmation of a scheme, *Re McInerney Homes Ltd* [2011] IEHC 4; the second an intermediary hearing allowing for a reconsideration of the matter [2011] IEHC 25; the third, judgment dealing with the effects of NAMA [2011] IEHC 61; and the final decision confirming refusal to confirm the scheme [2011] IEHC 63.

> two groups to financial ruin, and the companies to their present difficult unhappy state.

In terms of considering the relationship between law and non-legal norms, the role of the judiciary in this part of the unfolding story is worth considering. The statements of Kelly J in *Vantive Holdings* and O'Donnell J sound a sober and independent note in the midst of 'irrational exuberance' (a phrase originally coined by Alan Greenspan) which characterised the last days of the Celtic Tiger and the hubris that followed in its wake.

The role of shareholders: conclusion

On the basis of information available to us from the judgments and reported facts about these private companies, there seems to have been a total failure of any internal rules of company law to control the borrowing of these companies. No *ex ante* countervailing power emerged from the shareholders in these companies. There is no evidence, through litigation or through references in the judgments described above, to the existence of disagreement within these companies. There have been no reported minority shareholder actions arising from a questioning of decisions or a sense of disagreement with risks taken. No private shareholder actions have been taken on behalf of these companies against directors who may have acted recklessly or possibly breached duties in relation to skill and care or abuse of power. In other words, the range of company law remedies has remained a dead letter. What many of the property companies had in common was the dominance of a major shareholder, often a paterfamilias type of character. The exercise of borrowing decisions seems to have been a lot less about corporate governance and a lot more about family or personal relationship dynamics. The lack of diversity within the internal governance framework and the lack of sophisticated corporate governance structures were extraordinary given the monetary values involved. As the reports have stated, there is in contrast ample evidence of 'groupthink' and herd mentality.[74] This observation was reiterated by Mr Nyberg when he appeared at the Oireachtas Banking Inquiry in December 2014:

> I classify this as groupthink, which is thinking as one's peers does so as not to stick one's head up too far. It would explain to some extent the fact that everybody was unprepared for the crisis when it came and that everybody was more or less willing to accept the occurrence of risky behaviour on the part of the banks and the public sector. It is fair to say that it is also possibly one of the reasons that what happened not only in Ireland but in several other countries in the world was not caught, criticised or challenged by international organisations, academics, the media or consultants. Everybody believed in the same thing and nobody saw that for which they were not looking.

But there is also evidence of a strong family-type dynamic. Again, this is supported by observations from Mr Nyberg at the Oireachtas Banking Inquiry:

> As I already stated, a systemic crisis can arise only when a large number of risk-mitigating functions in many institutions in society have become impaired. For instance, it would be wrong to assign blame primarily to lenders and ignore the fact that a bad loan also requires that a borrower would have made a bad risk assessment on the possibility to handle credit.

Corporate governance: public law enforcement

A further possibility lies in a fairly dynamic proactive public law enforcement of directorial behaviour, disclosure regulations, audit and accounting regulation. As described, the work of the Office of the Director of Corporate Enforcement is very significant in the landscape

74 Nyberg report (n 3) para 1.6.

of Irish Company Law (see www.odce.ie and the Company Law Enforcement Act 2001).[75] However, this is *ex post facto* in its effect and, given the scale of the risktaking and its consequences, is completely inadequate to address the fall-out, even in terms of resources.

Similarly, no regulatory remedies were taken against any of these directors in the initial years, although there have been a few such initiatives recently reported.[76] In a more narrow company law framework, a key concept is that of recklessness with legal equivalents in UK law under wrongful trading provisions. A similar standard exists in Australian and New Zealand corporate law.[77] Admittedly, such standards are difficult to prove and this is not to presuppose the outcome of any such initiatives. It would seem that concerns which have been expressed regarding systemic risk are not easily matched with these standards.

Regulation of the banking sector was equally catastrophic. Despite the fact that both AIB and Bank of Ireland are stock exchange companies, there have been no corporate law remedies employed against any of the management (with the exception of the impending prosecution of executives in Anglo Irish Bank, now IBRC).[78] AIB and Bank of Ireland were sophisticated, stock exchange-quoted companies. This is not to suggest that particular individuals are accountable or ought to be accountable. The only point is that there has been no activity in relation to any of the remedies available in company law – either private or public remedies.

4 Back to basics: non-legal norms and law

In this section, there are a number of issues which feed into a consideration of how the law and legal rules interface with other non-legal norms and values. The nature of elites, the value of reputation and its preservation and other 'values' are important in how we understand the effectiveness of law.

Unconstrained capitalism

In this paper a number of aspects of the Irish story have been identified. An espousal of capitalism in its crudest form; a lack of engagement with political discourse regarding corporate function and the role of the corporation in our society; a lack of understanding of the importance of regulating the market to achieve social ends; and a lack of sophistication in our relationship to corporate form and its regulation, in particular an apparent lack of appreciation of the downside of commercial risktaking: all created the perfect storm. To date none of the major players, management or otherwise, have been held accountable to shareholders who lost the value of shares, particularly those in banks. Nor have we seen any management accountability to creditors of property development companies, primarily banker creditors which have now been taken over by the state or by the National Assets Management Agency (NAMA). Where shareholders cannot or do not

75 See Irene Lynch Fannon, 'The Dynamic Entrepreneur or the Totally Incompetent Fool? The Role of Norms in Identifying Legitimate Risk Taking under Irish Company Law' in R Keane and A O'Neill (eds), *Corporate Governance and Regulation* (Roundhall Press 2010) for a discussion of the work of the Office of the Director of Corporate Enforcement in taking disqualification and restriction actions against directors.

76 Criminal prosecutions for alleged breaches of s 60 Companies Act 1963 which prohibits financial assistance in the acquisition of a company's own shares were conducted in 2014 in relation to executives of AIB, now in liquidation as the IBRC; James Dwyer, 'No Surprise if Ultimately the Supreme Court Rules on Narrow Breach of Law in Anglo' *Irish Independent* (Dublin 22 April 2014).

77 Helen Anderson, 'Directors' Liability for Fraudulent Successor Company Phoenix Activity: A Comparison of the UK and Australian Approaches' (2014) 14 Journal of Corporate Law Studies 139–73.

78 'Anglo Executives McAteer and Whelan Charged over Alleged Euro 8m Fraud' *Irish Times* (Dublin 11 August 2014).

act to remedy such a loss, this must surely point to a lack of coherence in current corporate governance theories.

Family or group dynamics versus shareholder activism

Instead of what should have theoretically happened, either a collapse in share value where the corporate entities were listed companies or significant shareholder disquiet in private companies, perhaps expressed in some evidence of shareholder litigation, we are faced with no action whatsoever. The point is not that one would wish to see such eventualities, but the fact that these events did not occur raises questions about the relevance of company law, corporate governance principles and underlying theories.

The importance of property and history: 'to remember everything is a kind of madness'[79]

A culturally driven non-legal norm about the nature of wealth seems to have led Ireland in particular to an obsession with land and property development during the boom period leading to the financial crisis. Readily available funds were invested in property and land rather than in any other kinds of business development. In an interview with one of the developers who formed part of this group, Paddy Kelly, Fintan O'Toole described Kelly's situation in 2010.[80] He described how at the height of the boom Kelly was worth €350m. Now he's €350m in debt. In this interview Kelly made the very telling observation, as he and O'Toole drove to Castletown House in Celbridge, County Kildare, that: 'It was time the Irish went through the front gate.' In the interview with O'Toole he thought it important to tell O'Toole that his great-grandfather and namesake was imprisoned for his role in the Land League's struggle against ascendancy landlords. This relationship to the land – to property as a tangible source of wealth as distinct from manufacturing, retail, innovation and creativity – is part of our history, but also part of our downfall as we became increasingly reliant on one economic sector.

Groupthink and the tragedy of hubris

> What really makes Ireland attractive to corporate America is the kind of economy which we have created here. When Americans come here they find a country that believes in the incentive power of low taxation. They find a country that believes in essential regulation but not over-regulation. On looking further afield in Europe they also find that not every European country believes in all of these things. The figures speak for themselves. It is a remarkable fact that a country with just 1 per cent of Europe's population accounts for 27 per cent of US greenfield investment in Europe. Political and economic commentators sometimes pose a choice between what they see as the American way and the European way. They view the American way as being built on the rugged individualism of the original frontiersmen, an economic model that is heavily based on enterprise and incentive, on individual effort and with limited government intervention. They view the European way as being built on a strong concern for social harmony and social inclusion, with governments being prepared to intervene strongly through the tax and regulatory systems to achieve their desired outcomes . . . We in Ireland have tended to steer a course between the two but I think it is fair to say that we have sailed closer to the American shore than the European one. Look at what we have done over the last ten years.

79 Brian Friel, *Translations* (Faber and Faber, 1995).

80 Fintan O'Toole 'The Rise and Fall of a Celtic Tiger Tycoon' *Irish Times* (Dublin 17 July 2010).

> We have cut taxes on capital. We have cut taxes on corporate profits. We have cut taxes on personal incomes. The result has been an explosion in economic activity and Ireland is now the fastest-growing country in the developed world. And did we have to pay some high price for pursuing this policy option? Did we have to dismantle the welfare state? Did we have to abandon the concept of social inclusion? The answer is no: we didn't.[81]

This extract from the same speech cited above by the Tanaiste of the day in 2000 sums up the view of Ireland and its success which continued to feed into the Irish political sphere for the coming years. In retrospect these comments are breathtaking. Non-legal norms trump any legal principles available to those who might otherwise have used them. Shareholders, directors, creditors and others were quite simply not in a position to adequately assess the nature of the risks being taken, nor to do anything about them, certainly not in a legal sense. And so groupthink prevailed and the possibilities of giving voice to a countervailing view, particularly through legal means, became impossible. In a section entitled 'Herding and groupthink' the Nyberg report makes the following observation that:

> Groupthink occurs when people adapt to the beliefs and views of others without real intellectual conviction. A consensus forms without serious consideration of consequences or alternatives, often under overt or imaginary social pressure. Recent studies indicate that tendencies to groupthink may be both stronger and more common than previously thought . . . One consequence of groupthink may be herding, if the views in question relate to institutional policies, but this need not be the case. (para 1.6.5)

An independent[82] judiciary

As described above, the commercial court judges delivered particularly significant opinions at crucial points at the beginning of the crash. An independent and rigorous judiciary is recognised as one of the cornerstones of democracy. In Ireland, it became fashionable for members of the elite to openly criticise the judiciary for a lack of independence, in particular, allegations were made that some members of the judiciary were compromised in terms of personal exposure to property matters. Issues have arisen regarding judicial compensation and one litigant even questioned the independence of a judge simply on the basis that the judge had a mortgage with a bank involved in litigation against the litigant.[83] In particular, criticisms were made by particularly high-profile businesspeople in relation to deliberations of tribunals of enquiry. Although an independent judiciary is underpinned in Ireland by provisions of the Constitution, when we discuss the content of this principle we find that there is very little in terms of 'hard law' outlining what we mean by this kind of independence. For that reason, my theoretical framework considers the contours of judicial independence and the understanding of what this might mean when shaped by non-legal norms which pertain to the culture of the bench. If we are to continue the enquiry on how corporate governance and corporate law can interface more effectively with non-legal norms, the concept of independence might be a good place to start. We might indeed, as

81 See n 25.

82 See further Le Mire and Gilligan (n 57) for a discussion of the concept of independence in both contexts.

83 This concerned a statement made by Brian and Mary Pat O'Donnell in litigation presided over by Charleton J in the High Court in Dublin where they had been declared bankrupt. This allegation of bias was made in court and described by the judge as 'frankly absurd'; *Irish Times* (Dublin 2 September 2013).

has been suggested, look at this concept as it has applied to the judiciary and translate what we know about how this operates to board independence.[84]

A European solution to a European experience

Ireland's economic success was in part predicated on the openness of its economy – a factor which had changed considerably since the 1990s. The exposure of the banking sector to availability of funds from overseas was a consequence of this openness. In a small endnote, Hopt observes that 'the greed and short-sightedness of investors, including financial institutions, in particular the German State banks' also contributed.[85] The Irish state's banking bailout benefited bondholders in the Irish banks who had provided cheap sources of funding. Therefore, it is obvious that a European-wide approach is part of the solution to the difficulties. In her discussion of the European Single Supervisory Mechanism, Ferran[86] traces the development of this 'first fundamental step towards a European banking union' where the supervision of all Euro area banks will sit with the European Central Bank (ECB). Unfortunately, Ferran concludes on a pessimistic note, stating that regulatory harmonisation must underpin a functioning single supervisory mechanism: 'The less comprehensive the legal and regulatory framework at EU level, the more the ECB will have to rely on national authorities' which could lead to 'significant gaps in monitoring'.[87] A non-legal norm which will operate powerfully in this context relates to the sense of a collective European enterprise amongst Europeans generally. Ms Harney's speech referred to above reveals a rather negative sense of Europe in the Irish psyche.

Conclusion

J C Coffee observes in his conclusion on 'What Went Wrong?' that 'simple rules often work better than complex ones'.[88] Similarly, the extraction of simple conclusions, while often more challenging, can be more instructive.

In the last two decades, many scholars have considered various aspects of corporate governance, which is quite simply about accountability and legitimacy for those who control and manage corporate wealth. The failures of corporate governance theory and consequent rules raise questions about relevancy and about the following governance mechanisms, which had become central to corporate governance theory, corporate law theory and resulting legal standards. First, the market for corporate control is clearly irrelevant to the private company and, insofar as it relates to quoted or listed companies, had already been under scrutiny since the Enron days illustrated its failings. Second, shareholder activism was markedly absent in either the smaller 'corner shop' property-development companies or the larger, more formally operated 'multinational banks'. As a governance device, shareholder activism is enjoying renewed interest post-crisis, but it is interesting to note that no efforts

84 See further Donald C Langevoort, 'The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability' (2000) Georgetown University Law Center 241402/200 and Le Mire and Gilligan (n 57). The Capital Requirement Directive and Regulation (n 65) also tackle the concept of independence of directors, emphasising 'independence of mind' necessary to enable directors to 'constructively challenge and oversee the decisions of management. Members must act with honesty, integrity and independence.' Suzanne Le Mire has also made this connection between the concept of independence as it applies to the judiciary and corporate directors: Suzanne Le Mire and Gabrielle Appleby, 'Judicial Conduct: Crafting a System that Enhances Institutional Integrity' (2014) 38(1) Melbourne University Law Review 1.

85 Hopt (n 52).

86 E Ferran, 'The European Single Supervisory Mechanism' (2013) Journal of Corporate Law Studies 255.

87 Ferran (n 84) 285.

88 See Coffee, 'What Went Wrong' (n 4).

were made at any time by shareholders to actually formally remove directors from boards – a right which is present in both Irish and UK company law. Third, the value of independent directors must be doubted. Perhaps it is true that knowledge, expertise and experience in the sector are more important than independence. Even if we think that there are advantages to independence, a hanging question is whether law can create independence. Rules which prevent perverse incentives such as stock options are therefore important. Fourthly, the role of law in the face of powerful non-legal norms must be further examined. In this case, such norms include: reputational interests; other cultural values and norms (property ownership as wealth and status); and the interconnectedness of elites to political forces, regulators and lawmakers in terms of policy development, which requires further research. Finally, the crisis has illustrated difficulties with the European ideal which are seriously challenging. Even within the scope of this paper it is clear that further harmonisation of laws and, therefore, further integration must take place at all levels. The prospects of disintegration are even more challenging. Resistance to further harmonisation of laws at a European level and to any kinds of federalised enforcement arising from deeply held cultural or political positions (norms) in the European family is also a challenge.

NILQ 66(1): 23–42

Opening the door a crack: possible domestic liability for North-American multinational corporations for human rights violations by subsidiaries overseas?

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1 Introduction

Corporations have significantly expanded, both in terms of their number and in terms of their size and their international influence.[1] With that expansion has come a sometimes convoluted, and evolving, set of legal standards relating to whether a corporation has rights and responsibilities in various situations that previously might have only been attributed to individuals.[2] Beyond that, the law continues to evolve relating to how to pursue actions that involve multinationals and multiple jurisdictions.

The idea of implementing corporate social responsibility as a voluntary practice among multinational corporations has expanded in recent years, along with the increased globalisation of business practices.[3] The business benefits of this type of voluntary undertaking are obvious, as it is clearly not economically desirable for a business to be associated with human rights violations or destruction of the environment, among other potentially negative actions, domestically or overseas. In the same way, the business benefits for a multinational that has a strong record on human rights or environmental practices are also obvious.

In spite of voluntary standards implemented both across industries or by an individual multinational corporation, however, problems do still occur. Allegations of human rights and environmental violations by multinational corporations, either through the actions of a parent company or those of a subsidiary or agent, can present a number of complications. Logically, legal action for such violations carries the greatest likelihood of advancing when

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1 See L Westra, *Studies in Critical Social Sciences, vol 53: Supranational Corporation: Beyond the Multinationals* (Koninklijke Brill NV 2013) 5–10 (describing a significant rise in the number and reach of corporations in the past 150 years).

2 See ibid (giving examples of some of the legal confusion that has arisen from the changing nature of corporations); see also *Citizens United v Federal Election Commission*, Docket no 08-20, 558 US ___ (2010) (a highly controversial decision in the USA, in which the Supreme Court of the USA held that the First Amendment protected some forms of political spending by corporations, associations, or labour unions).

3 See generally A R Harrington, 'Corporate Social Responsibility, Globalization, the Multinational Corporation, and Labor: An Unlikely Alliance' (2011) 75(1) Albany Law Review 483. For an overview of efforts to bring about law reform in the area in Canada, see generally C Kamphuis, 'Canadian Mining Companies and Domestic Law Reform: A Critical Legal Account' (2012) 13 German Law Journal 1459.

brought against the person or entity directly responsible and in the jurisdiction in which the alleged violation occurred, and in which the parties are located.

It is not always possible for redress to be sought against an individual, however, and some circumstances may call for pursuing an action against a corporation. In some such cases, a parent company may be protected by the corporate veil, under which the parent and subsidiary are generally considered separate legal entities, and the parent is thus protected from liability incurred by the subsidiary.[4] Piercing the corporate veil can be challenging and difficult.[5]

Yet another complication arises when the alleged violation occurs in one country, and the plaintiffs seek to bring an action, either as an original action or as an enforcement matter, in another jurisdiction, generally the home jurisdiction of the parent corporation. The complication increases when allegations are made that the subsidiary committed human rights, or environmental, abuse, in a jurisdiction with questionable judicial systems, or where the country in which the subsidiary operates hesitates to strictly control the actions of the multinational corporation, for fear that it will move to another country, thus impairing the host country's economic status.[6]

Where parties seek to bring actions in another jurisdiction and against the parent for the alleged conduct of a subsidiary, a number of threshold barriers can arise.[7] Those barriers are especially apparent when the action is brought in a country that is not the place where the alleged action occurred, and the plaintiffs seek to simultaneously pierce the corporate veil.[8] As multinational corporations continue to expand in a globalised business world, courts in jurisdictions like Canada and the USA are grappling to set the parameters for what types of actions can be brought and where.

It is not uncommon for commentary surrounding these types of actions to use the metaphor of a door, discussing how far open that door is in relation to whether such actions are viable.[9] This metaphor illustrates many of the problems in these cases, as it is the

4 See *Choc v Hudbay Minerals Inc*, 2013 ONSC 1414, paras 43–9 (hereinafter *Choc v Hudbay* or *Choc*, explaining the narrow circumstances, under Ontario law, in which the corporate veil may be pierced).

5 See ibid. It is not entirely impossible to pierce the corporate veil. See e.g. *United Canadian Malt Ltd v Outboard Marine Corporation*, 48 OR 3d 352, [2000] OJ no 1554 (2000) (allowing an action to proceed against an American parent corporation regarding pollution on private property from undertakings of a Canadian corporation in Canada).

6 See C Nwapi, 'Jurisdiction by Necessity and the Regulation of the Transnational Corporate Actor' (2014) 30(78) Utrecht Journal of International and European Law 24, 24–6 (arguing for the use of the jurisdiction by necessity doctrine in such cases).

7 See *Choc v Hudbay* (n 4).

8 See ibid.

9 See e.g. O Hathaway, '*Kiobel* Commentary: The Door Remains Open to "foreign squared" cases,' (2013) online: SCOTUSblog <www.scotusblog.com/2013/04/kiobel-commentary-the-door-remains-open-to-foreign-squared-cases> accessed 10 September 2014; K Redford, 'Commentary: Door Still Open for Human Rights Claims after *Kiobel*' (2013) online: SCOTUSblog <www.scotusblog.com/2013/04/commentary-door-still-open-for-human-rights-claims-after-kiobel> accessed 10 September 2014. After a ruling on a motion to strike in *Choc v Hudbay Minerals Inc et al*, 2013 ONSC 998, discussed in this article, a number of commentators suggested that the proverbial door had been opened to claims involving alleged human rights violations overseas by subsidiaries of Canadian multinationals. See e.g. *Ernst v EnCana Corp*, 'Ontario Judgment Opens Door to Increased Risk for Canadian Mining Companies Working Abroad' online blog: <www.ernstversusencana.ca/ontario-judgment-opens-door-to-increased-risk-for-canadian-mining-companies-working-abroad> accessed 10 September 2014; P Collenette, 'After *HudBay* Ruling, Canadian Firms on Notice over Human Rights' (24 July 2013) online: theglobeandmail.com <www.theglobeandmail.com/globe-debate/after-hudbay-ruling-canadian-firms-on-notice-over-human-rights/article13386168> accessed 10 September 2014) ('The claims in the *HudBay* case have yet to be proved and the decision may be appealed, but a door that has been so firmly shut to so many victims has finally been opened in Canada.').

threshold issues that have traditionally presented the greatest challenges to such claims – such as questions of jurisdiction.[10] Plaintiffs seeking to bring such actions have traditionally faced significant barriers, or the metaphorical door, as well as confusion as to how far open that door really is, if it is open at all.

This article seeks to analyse some recent cases, particularly in Canada and the USA, with the objective of arguing that some factual scenarios should, and increasingly may, require courts in those countries to remove threshold procedural barriers to some of these cases proceeding in their jurisdictions. It does so by emphasising a high-profile case in Canada, which appears to have expanded the possibilities for such original actions to be brought in Canada, but does so in the context of a number of recent cases from other jurisdictions, which suggest that the law is not necessarily developing in a consistent manner across jurisdictions. The article does not attempt to present a comprehensive analysis on this form of liability, so much as to illustrate some of the questions raised by the recent cases discussed.

Moreover, while this article deals with questions of civil liability in such cases, it recognises the line of argumentation that suggests that increased expansion in the area of criminal liability may be increasingly viable in such cases, where it was not before, and that, overall, pursuing remedies under a criminal law model for 'unimaginable atrocities that deeply shock the conscience of humanity' is the better recourse in these cases.[11] As Professor James G Stewart notes:

> Compensation may be necessary, but can what Raphael Lemkin calls 'barbarous practices reminiscent of the darkest pages of history' really be redressed in *purely* monetary terms? Particularly in commercial contexts, the commodification of accountability risks allowing companies to absorb the cost of responsibility for international crimes, then pass this expense on to consumers, who pay incrementally more for weaponry, game consoles, cellphones and engagement rings. The inescapable threat, however, is that limiting accountability to civil recovery might allow corporations to purchase massive human rights violations.[12]

Stewart recognises, however, the reality that, in many cases, the choice can be one of either civil liability or of impunity.[13] Moreover, even if the criminal law develops in this respect, which is an intriguing, but still evolving, possibility, civil liability could be a viable option accompanying, while not necessarily replacing, the criminal law option, and, thus, has merit in its own right. It is the possibility of pursuing civil remedies that thus forms the main focus of this article.

Section 2 looks to the recent Canadian case, in which a trial court allowed three combined tort actions to proceed to trial against a parent corporation in Canada, even though the alleged incidents occurred in Guatemala. Section 3 looks at the American *Kiobel* case, which appears to have narrowed the scope of such actions in the USA, and examines some possible implications for such cases in the USA. Section 4 briefly examines similar forms of litigation in the UK and the Netherlands. Section 5 looks to still-developing

10 See e.g. *Choc v Hudbay* (n 4).

11 See J G Stewart, 'The Turn to Corporate Criminal Liability for International Crimes: Transcending the Alien Tort Statute' (2014) 47 NYU Journal of International Law and Politics, at 53, available at SSRN <http://ssrn.com/abstract=2354443> or <http://dx.doi.org/10.2139/ssrn.2354443> accessed 10 September 2014 (Accepted Paper Series) (quoting the Rome Statute of the International Criminal Court, Preamble).

12 Ibid (citations omitted).

13 Ibid 54.

scenarios regarding enforcement in domestic courts of judgments obtained overseas. Section 6 concludes by suggesting that, regardless of whether the law is settled on these issues, recent cases are having a practical effect on the operations of some multinational corporations. While positive, however, that effect is not enough to bridge the gap that exists in the ability of certain plaintiffs to obtain a fair hearing on their claims.

2 Canada props open the door?

2.1 Original actions proceed to trial

The case of *Choc v Hudbay Minerals* (*Choc*) has caused a stir in Canada because the trial judge denied motions to strike on a number of grounds, including jurisdiction, and has allowed the case to proceed to trial.[14] The case is at an early stage, so it is not clear what the outcome will be substantively, but with Hudbay announcing that it will not appeal the denial of the motion to strike, the ruling at least provides a lower-court decision in which an original action was allowed to proceed, uninhibited by jurisdictional barriers.[15]

The background facts of this case are extensive, as there is a long history of disputes over the land at issue in these actions.[16] Because the threshold issues in these cases can often be highly fact-specific, an exposition of the facts of this case is presented here to clarify the extent of what the trial judge actually decided.

The *Choc* case actually involves three actions, all brought by members of the Mayan Q'eqchi, who live in El Estor in Guatemala.[17] They brought actions against three entities. Hudbay Mining is a Canadian mining company.[18] HMI Nickel Inc (formerly Skye Resources Inc) owned and ran the Fenix Mining Project, a nickel-mining operation, at the time of the alleged actions in the *Caal* lawsuit (see below) and later 'amalgamated with Hudbay Minerals', making Hudbay legally responsible for Skye Resources' legal liabilities.[19] Compania Guatemalteca De Niguel (CGN) owned and operated the Fenix Mining Project and was a 98.2 percent-owned subsidiary of Hudbay. Hudbay sold the Fenix Mining Project, and CGN, in 2011, but as a condition of the sale agreed to retain responsibility for litigation involving CGN in these matters.[20]

The Mayan Q'eqchi people had long claimed the region as their ancestral land. Some of the dispute stemmed back to the prior conflict in Guatemala, when people were evicted from the same lands.[21] In 2006, the government of Guatemala issued a mining permit to CGN on the land, the same year that some members of the Mayan Q'eqchi moved back

14 See generally *Choc v Hudbay* (n 4).

15 See C Santry, 'Hudbay Won't Appeal Decision to Send Guatemala Case to Trial' (28 August 2013) online: canadianlawyermag.com <www.canadianlawyermag.com/legalfeeds/1648/hudbay-wont-appeal-decision-to-send-guatemala-case-to-trial.html> accessed 10 September 2014.

16 For a much more detailed discussion of the contextual facts around this dispute, see S Imai, B Maheandiran and V Crystal, 'Accountability Across Borders: Mining in Guatemala and the Canadian Justice System' in O Aginam (ed), *Transnational Corporations, Human Rights and Environmental Justice in Latin America* (United Nations University Press: forthcoming); also available online: <http://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi?article=1028&context=clpe> accessed 10 September 2014; see also A Pedersen, 'Landscapes of Resistance: Community Opposition to Canadian Mining Operations in Guatemala' (2014) 13(1) Journal of Latin American Geography 187 (explaining larger disputes in this area).

17 *Choc v Hudbay* (n 4) para 4.

18 Ibid para 8.

19 Ibid para 9.

20 Ibid para 10.

21 Imai et al (n 16) 39.

into the area.[22] Members of the community subsequently alleged 'numerous forced evictions, the burning of hundreds of homes, gunshots and alleged human rights atrocities, including those giving rise to these actions'.[23]

Around the time of the first of the incidents that gave rise to these actions, on 7 and 8 January 2007, Steven Schnoor, a PhD student at York University, filmed forced evictions in some El Estor communities.[24] Schnoor was in Guatemala, studying the relationship between Canadian mining companies and the local populations, supported by student funding, ultimately provided by the Canadian International Development Agency, to examine these relationships in Guatemala and Honduras.[25] The film showed houses being destroyed during the eviction, including still photos of houses being burned down.[26] Schnoor later made the film into a nine-minute documentary and posted it on YouTube.[27]

After the video was released, Ian Austin, chief executive officer and president of Skye Resources, confirmed, on the CBC radio programme, *As It Happens*, that evictions had happened in the area in early January.[28] He did not specifically comment on the video, saying he had not seen it, but said that the evictions were carried out by 'specially trained units of the police', and he confirmed that some structures were burned.[29]

Approximately three years later, Schnoor won a defamation action against the former Canadian ambassador to Guatemala, Kenneth Cook, and the attorney general of Canada. Cook had allegedly told an employee of a non-governmental organisation in Guatemala that a woman featured in the video, who expresses anger at the company for the evictions, was a paid actress. He also allegedly said that still photos of burning homes were years old, from a prior conflict and not from the recent evictions.[30]

2.2 The three specific actions in *Choc v Hudbay*

The *Choc* case actually involves a consolidation of three actions, relating to incidents that took place on different dates, but all three arose out of the series of evictions undertaken at the Fenix Mining Project. The case has not yet gone to trial, as of the publication of this article, and Hudbay has publicly stated that it expects the plaintiffs' allegations to be disproven at trial.[31]

22 'Guatemala: Guatemala Court Makes Landmark Ruling in Indigenous Rights Case' (21 April 2011) online: <http://edmortimer.wordpress.com/2011/04/21/guatemala-court-makes-landmark-ruling-in-indigenous-rights-case> accessed 10 September 2014; see also *Choc v Hudbay* (n 4) para 13.

23 *Choc v Hudbay* (n 4) para 13.

24 'Violent Evictions at El Estor, Guatemala' online: <www.youtube.com/watch?v=Q20YxkM-CGI&feature=player_embedded> accessed 10 September2014 (hereafter YouTube Forced Evictions); see also Imai et al (n 16) 14–15.

25 *Schnoor and Attorney General of Canada and Kenneth Murray Cook, Plaintiff's Amended Claim*, Ontario Court of Small Claims, para 1, online: schoorversuscanada.ca <www.schnoorversuscanada.ca/docs/statement-of-claim.pdf> accessed 10 September 2014.

26 YouTube Forced Evictions (n 24).

27 See ibid.

28 *Schnoor, Amended Claim* (n 25) para 13 (in his amended claim, Schnoor refers to an audio recording of this interview, which was attached to his claim, but could not be located in the version currently available online).

29 Ibid.

30 Denise Balkissoon, 'Former Canadian Ambassador Guilty of Slander' online: Thestar.com <www.thestar.com/news/gta/2010/06/17/former_canadian_ambassador_guilty_of_slander.html> accessed 10 September 2014.

31 Santry (n 15).

Caal v Hudbay Minerals Inc

In *Caal v Hudbay* (*Caal*), the plaintiffs are 11 women, who are members of the Mayan Q'eqchi. According to their amended statement of claim, in January 2007, during a forced eviction of Mayan Q'eqchi people, they were gang-raped by police, military and mine security personnel.[32] They allege that the security personnel 'were deployed at Skye Resources' Fenix Mining Project and were under the control and direction of Skye Resources'.[33] Skye Resources, they further allege, 'amalgamated with and is now a part of Hudbay Minerals'.[34] The statement of claim describes a series of violent forced evictions, followed by announcements by Skye Resources about the evictions.[35]

The plaintiffs allege that, on 17 January 2007, 'hundreds of members of the police and military and Fenix Security Personnel' returned to their village for another round of forced evictions, again, they assert, 'at the request of Skye Resources'.[36] The plaintiffs allege that the men of the village were not present, and that the plaintiffs tried to escape, some with their children, but that they were trapped.[37] Each of the 11 women says they were then gang-raped, and that some of the men participating in the rapes were wearing uniforms that had the logo 'CGN'.[38]

Rosa Elbira Coc Ich says she was sexually assaulted by nine men, and she said that several of them were wearing the uniforms of Fenix Security Personnel. Before the assault, she said that one of them held a gun to her head and threatened to kill her. She has alleged that she is no longer able to have children because of the attack.[39] In an interview, shown on Canadian television in late 2012, Ich told her story, crying and saying 'they destroyed my body'.[40]

Margarita Caal says that she was six months pregnant when she was raped by 10 men, including some who wore the uniform of Fenix Security Personnel. She alleged that she had difficulty walking after the attacks and, three months later, gave birth to a stillborn child.[41]

Irma Yolanda Choc Cac says that she 'was with her ten-year-old daughter when four police officers, four soldiers and four uniformed Fenix Security Personnel seized her', after which, she says, all 12 of them raped her. She was three months pregnant at the time and she subsequently suffered a miscarriage.[42]

Elena Choc Quib, Olivia Asig Xol, Amalia Cac Tiul, Lucia Caal Chún, Luisa Caal Chún, Carmelina Caal Ical, Elvira Choc Chub and Irma Yolanda Choc Quib each alleged that they were 'physically assaulted and raped by several police, military and uniformed Fenix Security Personnel'.[43] The plaintiffs further alleged that, that same day, the Skye Resources president

32 See *Caal v Hudbay Minerals Inc, Amended Statement of Claim*, Court File no CV-11-423077 online: <www.chocversushudbay.com/wp-content/uploads/2010/11/Amended-Statement-of-Claim-Caal-v.-HudBay-FILED.pdf> para 1, accessed 10 September 2014.

33 Ibid para 1.

34 Ibid (original emphasis removed).

35 Ibid paras 48–61.

36 Ibid para 62.

37 Ibid para 63.

38 Ibid para 64.

39 Ibid para 65.

40 Ich was interviewed, along with Angelina Choc and German Chub Choc, in 2012, in anticipation of the upcoming court proceedings; The National, 'Seeking Justice' (2012) online: YouTube <www.youtube.com/watch?v=0fkT3vLA6qg> accessed 10 September 2014.

41 *Caal Amended Statement of Claim* (n 32) para 66.

42 Ibid para 67.

43 Ibid paras 68–75.

issued a letter stating that Skye Resources was working with CGN to resolve issues regarding the dispute, acknowledging the dispute and saying '**[t]he company did everything in its power to ensure that the evictions were carried out in the best possible manner while respecting human rights**'.[44]

Hudbay has subsequently posted a statement concerning its operations in Guatemala. Relating to the events alleged in the *Caal v Hudbay Amended Statement of Claim*, their representatives wrote:

> In January 2007, pursuant to court orders, the Guatemalan prosecutor conducted several legal evictions on the CGN property with assistance from the National Civilian Police and National Army. Hudbay does not believe the allegations that sexual assaults occurred during these evictions [are] credible and no complaints of this nature have been filed with the authorities in Guatemala. In fact, on the date the plaintiffs claim the sexual assaults took place, the police report indicates that no illegal occupiers were present when the prosecutor and members of the Police and Army attended to implement the eviction.[45]

Choc v Hudbay Minerals Inc

The next of the three actions was brought by Angelina Choc, individually and as the widow and personal representative of the estate of Adolfo Ich Chamán. The plaintiff alleges that, on 27 September 2009, her husband was 'hacked and shot to death by private security forces employed by a subsidiary of Canadian mining company Hudbay Minerals Inc'.[46]

According to the Statement of Claim, Adolfo was a respected leader in the Mayan Q'eqchi community, as well as a teacher.[47] He was also outspoken on the issue of Mayan Q'eqchi land rights, and he had five children.[48] After the forced evictions in 2006 and 2007, the plaintiff alleged that she and Adolfo, along with their children, returned to the land from which they had been evicted.[49] Two weeks before he died, Adolfo held a meeting with representatives of the government at different levels, asserting that they had failed to consult with the Mayan Q'eqchi people 'as required under international and Guatemalan law', and he spoke against the previous violent evictions.[50]

Community fears over another forced eviction led to a series of protests on 27 September, and Adolfo participated in the protests.[51] Angelina says that, after Adolfo returned home, he heard the sounds of gunshots from the direction of the Fenix Mining Project, and he went to investigate what was happening and was not armed.[52] She says that, as he approached the area, the head of security appeared to recognise him and 'approximately a dozen armed members of the Security Forces came through a gap in the fence, surrounded Adolfo Ich and immediately began to beat him'.[53]

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44 *Caal Amended Statement of Claim* (n 32) para 76 (emphasis in Statement of Claim).

45 Hudbay, 'The Facts: Hudbay's Former Operations in Guatemala' online: hudbayminerals.com <www.hudbayminerals.com/English/Responsibility/CSR-Issues/The-facts-Hudbays-former-operations-in-Guatemala/default.aspx#link1> accessed 10 September 2014.

46 *Choc v Hudbay Minerals Inc, Second Amended Fresh as Amended Statement of Claim*, Court File no CV-10-411159 online: <www.chocversushudbay.com/wp-content/uploads/2010/11/Second-Amended-Fresh-as-Amended-Choc-v.-HudBay-FILED.pdf> para 1, accessed 10 September 2014.

47 Ibid para 8.

48 Ibid.

49 Ibid para 43.

50 Ibid para 47.

51 *Choc Second Amended Fresh as Amended Statement of Claim* (n 46) paras 52–3.

52 Ibid para 54.

53 Ibid para 56.

After then dragging him through the gap in the fence, Angelina alleges that 'a member of the Fenix Security Forces struck Adolfo Ich on the right forearm with a machete, nearly severing his arm from his body'.[54] She alleges that the head of security then approached Adolfo and shot him in the head.[55] The security forces then dragged him back to the Fenix Mining Building as he cried for help. People were prevented from intervening by gunfire, and Adolfo later died from his injuries.[56] Later it was learned that his injuries included 'a bullet wound to his throat, fragmented left ear bones, a shattered jaw, a partially severed right forearm, a broken right arm, blunt force trauma wounds to his head and skull and a lacerated left shoulder'.[57] Angelina further alleges that, at the time Adolfo was attacked, he was not physically present at the protests and was, in fact, separated from them by physical structures.[58]

The plaintiff alleges that Peter Jones said, on behalf of Hudbay and in response to Adolfo's death, '[o]ur number one priority is to ensure the safety and security of all residents and employees in El Estor . . . We remain committed to working with local residents to reach a fair and equitable solution to land claims and resettlement.'[59]

Chub v Hudbay Minerals Inc

Another incident, also occurring on 27 September 2009, gave rise to the third action in these combined claims. This third action was brought by German Chub Choc ('Chub'), alleging that he was shot in the head, 'at close range' on that day, and that the attack 'left him paralyzed and without use of his left lung'.[60] Mr Chub alleged that he was watching a soccer game when a number of Fenix Security forces drove up, some of whom were wearing CGN uniforms, and carrying a variety of weapons, including 'handguns, shot-guns, machetes, pepper-spray and tear gas'.[61] Chub also alleged that he was not involved with the protests that day and that there were no protests near where the game was being played.[62]

Chub says that some of the security guards approached him as he was standing next to the soccer field, which was a few metres from the Fenix Compound.[63] He said he saw one of them, identified as Padilla, take out a handgun and aim it at him and that, as he turned to run, Padilla shot him.[64] The bullet 'entered Mr. Chub's left shoulder, *punctured his left lung*, travelled through his chest cavity and *badly damaged his spinal column*'.[65] He alleged that Padilla and the other security guards did not try to help him after he had been shot, but instead left.[66] After extensive medical treatment, Chub was left without the use of his left lung, and as a paraplegic, and the bullet is still lodged in his chest.[67]

54 *Choc Second Amended Fresh as Amended Statement of Claim* (n 46) paras 56–7.

55 Ibid para 57.

56 Ibid paras 58–9.

57 Ibid para 59.

58 Ibid para 60.

59 Ibid para 86.

60 *Chub v Hudbay Minerals Inc, Amended Statement of Claim*, Court File no CV-11-435841 online: <www.chocversushudbay.com/wp-content/uploads/2010/11/Amended-Statement-of-Claim-Chub-v.-HudBay-FILED.pdf> para 2, accessed 10 September 2014.

61 Ibid para 49.

62 Ibid para 50.

63 Ibid para 52.

64 Ibid.

65 Ibid (emphasis in original).

66 Ibid.

67 Ibid para 54.

As to the incidents of 27 September 2009, Hudbay wrote that protestors attacked participants in a meeting, designed to resolve the dispute, and that they also continued a blockade in the area. Hudbay asserted that the blockade set off a number of disputes, including destruction of newly constructed homes on CGN property and an attack on a CGN-sponsored community hospital on CGN property. Hudbay further alleges that protestors broke into the local police station and stole weapons that were later used in the hospital attack. 'Throughout the attacks', Hudbay representatives wrote:

> CGN security and other personnel showed extraordinary restraint and acted only in self defence. Their measured response to the various attacks helped to prevent a further escalation of violence, thus limiting the number of injuries on both sides of the confrontation.[68]

Hudbay noted that five CGN security personnel were injured during the incidents. Finally, Hudbay representatives stated '[u]nfortunately, a protestor died that day. Based on internal investigations and [eyewitness] reports, Hudbay believes that CGN personnel were not involved with his death'.[69]

Throughout the statements from both sides, certain narratives emerge. The plaintiffs repeatedly assert that they have a right to the land from which they were evicted as it is their ancestral land.[70] Hudbay consistently refers to the plaintiffs and the others evicted from the lands as 'illegal occupiers' or as 'squatters'.[71] On 8 February 2011, after the events at the heart of this action, the Constitutional Court of Guatemala found that the Mayan Q'eqchi had stated a valid claim to the land and ordered the government to recognise their 'collective property rights'.[72] Hudbay sold the Fenix Mining Project to Solway Investment Group in September 2011, and there have been reports of escalating violence since then.[73] Some sources indicate that the case from the Constitutional Court applies, not to the land at issue in this dispute, but to the land just next to the site of the 2007 evictions that are at issue in this case.[74] Either way, it is sufficiently relevant to have been mentioned as important by the Ontario Superior Court in its ruling on the motion to strike.[75]

2.3 Opening the door a crack?

The plaintiffs in these three actions did not initiate the cases in Guatemala, where the incidents occurred, because of concerns over corruption in the Guatemalan judicial system, which would make proceeding there difficult if not impossible.[76] In addition to corruption within the judicial system, there have been reports of significant violence among those

68 Hudbay (n 45).

69 Ibid.

70 See e.g. *Choc Second Amended Fresh as Amended Statement of Claim* (n 46) para 38.

71 See e.g. Hudbay (n 45).

72 *Choc v Hudbay* (n 4) para 12 (the *Hudbay* court referred to this decision without citing it). For an English language discussion of the case, see Imai et al (n 16) (citing *Expediente* 934-2010 (8 February 2011)).

73 Indian Law Resource Center, 'Center Secures Protection for Leaders in Guatemala Case,' online: <www.indianlaw.org/content/IACHR_grants_precautionary_measures> accessed 10 September 2014.

74 See Imai et al (n 16) 36 (discussing *Expediente* 934-2010 (8 February 2011)).

75 *Choc v Hudbay* (n 4) para 12.

76 Ibid para 24. This conclusion is supported by reports describing impunity for perpetrators of human rights violations in Guatemala. See e.g. Human Rights Watch, 'World Report 2013: Guatemala' online: <www.hrw.org/world-report/2013/country-chapters/guatemala> accessed 10 September 2014 (noting that there had been some progress relating to human-rights violations in Guatemala in 2012, but that 'impunity remains the norm in Guatemala'); Amnesty International, 'Guatemala Human Rights' online: Amnesty International <www.amnestyusa.org/our-work/countries/americas/guatemala> accessed 10 September 2014): 'Guatemala continues to be crushed by the rule of impunity.'

either going against the military, or, more recently, those vocal opponents of mining operations in Guatemala.[77]

The plaintiffs alleged both direct responsibility of Hudbay Minerals, under tort theory, and also that the corporate veil should be pierced, or that vicarious liability should be found against Hudbay.[78] The trial court allowed Amnesty International to intervene in the case, and it presented to the court extensive material on voluntary and international agreements regarding corporate social responsibility.[79] The ultimate outcome of the case will depend on the upcoming trial, but in July 2013, the Ontario Superior Court heard Hudbay's motion to strike.

The plaintiffs had generally alleged that security personnel worked for Hudbay's subsidiaries and that the subsidiaries were 'under the control and supervision of Hudbay' in committing the human rights abuses.[80] In relation to all three claims, the defendants brought a motion to strike, essentially arguing that plaintiffs had failed to state a case on which relief could be granted. There were several factual arguments underlying this assertion, but the one relating to the separate corporate personality of the parent versus the subsidiary will be highlighted here.[81]

In assessing a motion to strike, the court must decide whether 'assuming the facts in the statement of claim can be proven, it is plain and obvious that no reasonable cause of action is disclosed'.[82] Thus, the facts alleged are assumed to be true for the purpose of the motion, and the question is whether the facts as alleged are sufficient to support a cause of action – a standard that strongly favours the plaintiff.[83]

The court noted that the majority of the plaintiffs' claims were based on direct liability of Hudbay, based on its own conduct.[84] It was only in relation to the *Choc* action that the argument was made that the corporate veil should be pierced, and this was in addition to an assertion of direct liability for certain torts.[85]

'Piercing the corporate veil' is, generally, based on the idea that a parent corporation is considered a separate legal entity from a subsidiary. Thus, generally, a parent cannot be sued for the actions of the subsidiary unless a way can be found to pierce the corporate veil.[86]

The court noted that Ontario courts have recognised three situations in which the corporate veil may be pierced:

> (a) where the corporation is 'completely dominated and controlled and being used as a shield for fraudulent or improper conduct' . . .
>
> (b) where the corporation has acted as the authorized agent of its controllers, corporate or human . . . and
>
> (c) where a statute or contract requires it.[87]

77 Imai et al (n 16) 3–4.

78 *Choc Second Amended Fresh as Amended Statement of Claim* (n 46) para 1.

79 *Choc v Hudbay* (n 4) paras 32–9.

80 Ibid para 4.

81 Ibid paras 17–18.

82 Ibid para 40.

83 See ibid para 42.

84 Ibid para 43.

85 Ibid (n 4) para 43.

86 Ibid para 44.

87 Ibid para 45 (internal citations omitted).

In the *Choc* action, the plaintiffs did plead that 'CGN is an agent of Hudbay Minerals.' In so doing, the court said, they pleaded the second exception, and, while the court did not find the first exception to have been successfully pleaded, and did not find the third to be applicable, it did accept that the second exception was properly pleaded. Thus, if proven, the pleadings contained enough to pierce the corporate veil.[88]

The plaintiffs also argued that a parent can be liable in tort for its 'own acts or omissions in another country' and 'jointly and severally liable' with a subsidiary if its actions so suggest.[89] The court noted that the plaintiffs were not arguing that Hudbay was responsible for the actions of the security personnel, but, rather, that it was, itself negligent in failing to anticipate and avoid the situation.[90] The court then went through each element of the torts alleged and explained why the pled facts, if proven, would be adequate to state the claim. For example, the court said that the plaintiffs pleaded sufficient facts to support their claim in tort and, if proven, enough to establish that the:

> harms were a reasonably foreseeable consequence of the defendants' act because:
>
> * Hudbay/Skye knew or should have known that in Guatemala, violence is frequently used by security personnel during the forced evictions of Mayan Q'eqchi' communities;
> * Hudbay/Skye executives specifically knew that violence had been used at the previous forced evictions of Mayan Q'eqchi communities requested by Hudbay/Skye;
> * Hudbay/Skye knew that there was a higher risk that more extreme forms of violence would be used during the eviction of remote communities;
> * Hudbay/Skye knew that the security personnel were unlicensed, inadequately trained and in possession of unlicensed and illegal firearms;
> * Hudbay/Skye knew or should have known that the level of violence and rape against women in Guatemala is very high; and
> * Hudbay/Skye knew that Guatemala's justice system suffers from serious problems and the vast majority of violent crime goes unpunished.[91]

Hudbay had argued that some of the facts pled by the plaintiffs would be proven false, and the court noted that the facts are presumed true for the purpose of a motion to strike.[92] The court cannot make determinations at the stage of a motion to strike as to whether the facts are proven or true, but just as to whether they are adequately pled, so the actual findings of fact in this case remain to be seen and, as of the writing of this article, none of the allegations have yet been proven at trial.[93]

CGN had asked, in the event that the allegations against Hudbay and HMI were stricken, that the action against it be permanently stayed for lack of jurisdiction, saying the Ontario court had no jurisdiction over a Guatemalan company. Because the court had not stricken the actions against Hudbay and HMI, this request was also denied.[94]

88 *Choc v Hudbay* (n 4) paras 47-49.
89 Ibid para 50.
90 Ibid para 52.
91 Ibid para 60.
92 Ibid para 42.
93 See ibid.
94 Ibid para 85.

The result of the court's ruling is that this action can proceed to trial, and, again, that there is now a decision, *albeit* from a lower court, that says that, should the facts in the statements of claim be proven, they would be adequate to establish Hudbay's liability for its direct actions in Guatemala, as well as to pierce the corporate veil. Whether the facts will be proven, of course, is another matter. Even if the plaintiffs do not succeed at trial, the fact that Hudbay has elected not to appeal the Ontario decision suggests that this case will still stand for the proposition that there are some factual scenarios under which plaintiffs can sue a Canadian parent corporation and its subsidiaries for human rights violations committed overseas – at least in the province of Ontario, and at least according to a lower court. So, even in Ontario, this may not be the last word on that point more generally.[95]

3 Closing, but not locking, the door in the USA

3.1 Original action barred by the Supreme Court of the United States

There is some difficulty in extrapolating a clear rule on when or whether these types of actions can be brought, in part because the issue continues to evolve. One rule that recently emerged from the US Supreme Court appeared to close the door on one previously promising avenue, but, as at least one subsequent case suggested, the door remains unlocked.[96] Prior to this decision, and because of specific provisions under US law, so-called 'foreign-cubed' cases, 'in which foreign defendants are sued by foreign plaintiffs for torts committed on foreign soil', could sometimes be brought in the USA.[97]

In *Kiobel v Royal Dutch Petroleum Co et al*, a group of Nigerian-born plaintiffs, who were living in the USA, attempted to bring an action against Royal Dutch Petroleum, Shell Transport and Trading Company, and Shell Petroleum Development Company of Nigeria Ltd, asserting that the companies had aided the Nigerian government in committing acts that amounted to violations of customary international law.[98] The companies involved are incorporated in the Netherlands, the UK and Nigeria.[99] Specifically, the plaintiffs alleged that the corporations had assisted the Nigerian government in a violent crackdown on peaceful opposition to expanded oil development in the region.[100] During the government's crackdown, Nigerian military and police forces attacked Ogoni villagers, and there were allegations of beatings, rapes, killings, arbitrary detentions and destruction or looting of property.[101] The plaintiffs alleged that the corporations 'aided and abetted these atrocities by, among other things, providing the Nigerian forces with food, transportation, and compensation, as well as by allowing the Nigerian military to use respondents' property as a staging ground for attacks'.[102] Esther Kiobel is the widow of one of the so-called 'Ogoni nine', a group of activists who were executed by hanging by the military dictatorship in

95 See Santry (n 15).

96 See *Kiobel v Royal Dutch Petroleum Co*, 133 S Ct 1659 (2013). Compare *In Re South African Apartheid Litigation*, 02 MDL 1499 (SAS) (SDNY 2014) (listing actions involved) online: Opinio Juris <http://opiniojuris.org/wp-content/uploads/17-Apr-SDNY-Opinion.pdf> accessed 10 September 2014.

97 Stewart (n 11) 7, note 10.

98 *Kiobel* (n 96) 1662.

99 Ibid.

100 Ibid.

101 Ibid.

102 Ibid 1662–3.

Nigeria.[103] All of the plaintiffs are now residents of the USA.[104] The three corporations were named in the action, because, as the court explained:

> When the complaint was filed, respondents Royal Dutch Petroleum Company and Shell Transport and Trading Company, plc, were holding companies incorporated in the Netherlands and England, respectively. Their joint subsidiary, respondent Shell Petroleum Development Company of Nigeria, Ltd (SPDC), was incorporated in Nigeria, and engaged in oil exploration and production in Ogoniland.[105]

The action was brought under the Alien Tort Statute, which, prior to the *Kiobel* decision, was a long-standing mechanism for allowing so-called 'aliens' to gain jurisdiction before US courts. The statute dates back to 1789.[106] The statute provide that '[t]he district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States'.[107]

Prior to the *Kiobel* ruling from the Supreme Court, the lower circuits had been in some disarray as to whether a corporation could face liability under the Alien Tort Statute before a US court relating to human rights violations allegedly committed abroad.[108] It appeared, initially, as if the *Kiobel* court had decidedly answered the question in the negative when it ruled that the general presumption against extraterritorial application of US law included the Alien Tort Statute, thus precluding this recourse for these plaintiffs.[109] The court did appear to leave the door open for some future cases, requiring that, in order to overcome the presumption, the claims must 'touch and concern the territory of the United States, [and that] they must do so with sufficient force to displace the presumption against extraterritorial application'.[110] In making this ruling, the court appeared to eliminate a significant avenue for plaintiffs to bring actions for human rights violations committed overseas.

In another case, issued the year before *Kiobel*, the Supreme Court ruled that the Torture Victim Protection Act did not apply to the actions of organisations, because the term 'individual', as used in the Act, only included natural persons and not organisations.[111] That case had related to allegations of torture by the Palestinian Liberation Organization and was brought against the Palestinian Authority and the Palestinian Liberation Organization by a

103 Center for Constitutional Rights, 'Factsheet: The Case Against Shell' online: ccrjustice.org <http://ccrjustice.org/learn-more/faqs/factsheet%3A-case-against-shell-0> accessed 10 September 2014.

104 *Kiobel* (n 96) 1662.

105 Ibid.

106 Alien Tort Statute, or, alternatively, Alien Torts Claims Act of 1789, 28 USC §1350.

107 Ibid.

108 For some background on this case and on the issue in the USA, see M Theophila, '"Moral Monsters" under the Bed: Holding Corporations Accountable for Violations of the Alien Tort Statute after *Kiobel v Royal Dutch Petroleum Co*' (2011) 79(6) Fordham Law Review 2859; J M Stanisz, 'The Expansion of Limited Liability Protection in the Corporate Form: The Aftermath of *Kiobel v Royal Dutch Petroleum Co*' (2010–2011) 5 Brook Journal of Corporate Finance and Company Law 573 (both published prior to the ruling from the Supreme Court).

109 *Kiobel* (n 96) 1669.

110 Ibid. One commentator described this as '[t]he federal courthouse doors are now shut for these cases', but noted that 'the keys may still be in the door', if a degree of connection can be shown with the USA, consistent with the language in *Kiobel*: Donald Childress, '*Kiobel* Commentary: An ATS Answer with Many Questions (and the Possibility of a Brave New World of Transnational Litigation)' (18 April 2013) online: SCOTUSblog <www.scotusblog.com/2013/04/kiobel-commentary-an-ats-answer-with-many-questions-and-the-possibility-of-a-brave-new-world-of-transnational-litigation> accessed 10 September 2014.

111 *Mohamad v Palestinian Authority*, 132 S Ct 1702, 182 L Ed 2d 720 (2012) [2012 BL 95451].

naturalised US citizen.[112] Presumably, this decision limits actions against corporations under this Act.

Thus, while the trend of US Supreme Court decisions seems to have recently disfavoured bringing actions against corporations, current jurisprudence does not necessarily preclude such actions entirely. First, the decisions relate to actions under particular statutes, and the decisions are crafted to the parameters of the particular case. In *Kiobel*, for example, the court ruled that there was a presumption against extraterritorial application, not that there was an absolute bar.[113] The court did not suggest that there was a bar to liability of corporations, a question it did not expressly answer, but some believe the opinions operate under the assumption that there is this potential for some liability.[114] There are, as well, certain circumstances under which the presumption against extraterritoriality can be overcome.[115] The court did allow for the possibility that a matter could overcome the presumption if it relates to the territory and a concern of the USA with 'sufficient force'.[116] Anupam Chander, a professor at the University of California, Davis, has made a persuasive argument that, in practice, this connection requirement could mean that foreign corporations are not normally likely to fall under the Alien Torts Statute, but that American corporations are much more likely to meet this connection test.[117]

A question over what this means in the USA for these cases after *Kiobel* has arisen after a subsequent ruling by the US District Court for the Southern District of New York.[118] In *In Re South African Apartheid Litigation*, the court was faced with the question of an extraterritorial claim, under the Alien Torts Statute, against Daimler, Ford and IBM, alleging that these corporations aided the South African government in human rights violations.[119]

The trial court declined to dismiss the case, finding instead that the burden of overcoming the presumption against such extraterritorial application had been met in this case, and also finding that the Alien Torts Statute could, indeed, apply to corporations.[120]

112 *Mohamad v Palestinian Authority* (n 111).

113 See e.g. K Redford, 'Commentary: Door Still Open for Human Rights Claims after *Kiobel*' (17 April 2013) online: SCOTUSblog <www.scotusblog.com/2013/04/commentary-door-still-open-for-human-rights-claims-after-kiobel> accessed 10 September 2014.

114 Ibid.

115 Ibid.

116 *Kiobel* (n 96) 1669.

117 A Chander, 'Unshackling Foreign Corporations: *Kiobel*'s Unexpected Legacy' (2013) 107 American Journal of International Law 829, 830–2. The *Kiobel* case has generated considerable commentary, most speculating as to its long-term impact. See e.g. C Kaeb and D Scheffer, 'The Paradox of *Kiobel* in Europe' (2013) 107(4) American Journal of International Law 852 (suggesting that Europe may not be as aligned with the majority position in *Kiobel* as it may seem, specifically noting that the UK and the Netherlands took positions in *amicus* pleadings against extraterritoriality, but that this does not exactly align with their own handling of these cases); V Curran and D Sloss, 'Reviving Human Rights Litigation after *Kiobel*' (2013) 107(4) American Journal of International Law 858; Zachary D Clopton, '*Kiobel* and the Law of Nations' (2013) 107(4) American Journal of International Law E1; S H Cleveland, 'The *Kiobel* Presumption and Extraterritoriality' (2013) 52(1) Columbia Journal of Transnational Law 8; F R Teson, 'The *Kiobel* Decision: The End of an Era' (2013) 8(1) New York University Journal of Law and Liberty 161.

118 For an interesting analysis of this controversy, see J Ku, 'The Case That Won't Die: US Court Revives South Africa Apartheid Alien Tort Statute Lawsuit' (18 April 2014) online: Opinio Juris <http://opiniojuris.org/2014/04/18/case-wont-die-u-s-court-revives-south-africa-apartheid-ats-lawsuit> accessed 10 September 2014.

119 Human Rights@Harvard Law, '*In Re South African Apartheid Litigation*' online: <http://hrp.law.harvard.edu/areas-of-focus/alien-tort-statute/in-re-south-african-apartheid-litigation> accessed 10 September 2014).

120 *In Re South African Apartheid Litigation* (n 96) (listing actions involved).

This latter finding is especially intriguing as, in the lower-court *Kiobel* case, the Second Circuit Court of Appeal had specifically found that it did not so apply.[121] Although, as the lower court in the same federal circuit, the trial court should have been bound by the Second Circuit Court of Appeal, it expressly declined to follow that ruling because the Supreme Court had subsequently decided the *Kiobel* case on different grounds and had implied that the Alien Torts Statute could, in some cases, apply to corporations.[122] The plaintiffs have subsequently filed a motion for leave to file amended complaints, arguing that there are adequate facts to meet the 'touch and concern' portion of the *Kiobel* test.[123] Thus, even in that district, this question is by no means settled, but the ruling does suggest some willingness among certain courts to find a way to allow such cases to proceed in US courts, even after the seemingly dispositive handling of the issue by the Supreme Court in *Kiobel*.

The configurations for original actions may vary, and this may have a direct impact on jurisdictional and other threshold questions. The Canadian *Choc* case relates to the bringing of an original action in the jurisdiction that is the home of the parent company, even though the alleged violations took place overseas and involved varying degrees of connection among the parties to the country in which the action is to be brought.[124]

In *Kiobel*, the configuration was quite different, involving entities incorporated in three foreign jurisdictions, but not in the USA, where the action was brought. The actions at the heart of that lawsuit also happened outside of the USA and, although the plaintiffs subsequently moved to the USA, the connection to the USA in the *Kiobel* matter is arguably more tenuous than that presented in the Canadian *Choc* case.[125] If not for the existence of the Alien Torts Statute, a particular statutory tool, it is unlikely that the plaintiffs would have even attempted to bring the action in the USA. Canada has no such comparable statute, so it is unlikely that such an original action would have been attempted in Canada without a further connection to help meet threshold tests. This is an issue that will continue to develop.

4 Original actions in other jurisdictions

Courts in other jurisdictions also continue to struggle with when and how such actions can be brought in their domestic courts. In the UK, Shell Petroleum Development Company of Nigeria Ltd has avoided a High Court case that was about to start by agreeing to a £55m settlement.[126] The dispute is the result of two oil spills in Nigeria in 2008, which 15,000 members of Nigeria's Bodo community have said caused extensive environmental damage and significantly harmed their subsistence livelihood, including undermining their fishing operations. Shell has admitted responsibility for the oil spills, but does not agree as to the

121 Human Rights@Harvard Law (n 119).

122 Ibid.

123 Ibid referring to *Kiobel* (n 96) 1669.

124 *Choc v Hudbay* (n 4) paras 8–10.

125 See *Kiobel* (n 96) 1662.

126 'Shell Announces £55 Million Payout for Nigeria Oil Spills' (7 January 2015) online: theguardian.com <www.theguardian.com/environment/2015/jan/07/shell-announces-55m-payout-for-nigeria-oil-spills> accessed 1 April 2015; see also AFP, 'Nigerian Community Fights Shell in UK Court over Oil Spills' (29 April 2014) online: theguardian.com <www.theguardian.com/environment/2014/apr/29/nigerian-community-shell-uk-court-oil-spills> accessed 10 September 2014; *The Bodo Community, Gokana Local Government Area, Rivers State, Nigeria and the Shell Petroleum Development Company of Nigeria Ltd*, Claim no HQ11X01280, Particulars of Claim, in the High Court of Justice, Queen's Bench Division, online: Platform London <http://platformlondon.org/wp-content/uploads/2012/06/The-Bodo-Community-and-The-Shell-Petroleum-Development-Company-of-Nigeria-Ltd.pdf> accessed 10 September 2014.

assertions regarding liability for and the amount of the damage.[127] Earlier attempts to settle the matter had failed, and the case was set for a pre-trial hearing where, among other things, Shell's position that the cases should be heard in Nigeria was to be presented.[128] Early indications had been that the court was open to hearing certain threshold issues on the merits, and the case was expected to proceed to trial in 2015.[129]

A case has been proceeding in the Netherlands against Shell relating to oil spills in Nigeria, and it has met with success so far.[130] The case is ongoing, at the appellate level, and this article mentions it, and commentary surrounding this case, merely for the proposition that the Netherlands may turn out to be one jurisdiction in which courts may allow for such liability for alleged human rights violations abroad.[131] It appears that there may even be some circumstances in which criminal liability might be found.[132]

5 Enforcement actions for foreign judgments

Another line of controversy exists, though, involving cases in which the original action is brought in the country in which the alleged abuses took place, and the parties then seek to enforce the foreign judgment in another national jurisdiction afterwards. Again, it is not so clear what the parameters of such actions are.

A US federal court recently issued a scathing 485-page ruling in an action that began as a request for enforcement of a judgment entered in Ecuador for alleged environmental abuses by the Chevron Corporation.[133] Chevron had brought a separate action against Steven Donziger, the lead attorney for the plaintiffs, seeking to block the enforcement and alleging that various actions in the obtaining of the underlying Ecuadorian judgment were fraudulent.[134] The federal trial court agreed with Chevron and prohibited Donziger or the others from seeking to enforce the Ecuadorian judgment in the USA.[135] In April 2014, Donziger, sought, unsuccessfully, to stay enforcement of the ruling.[136] The Chevron ruling

127 *The Bodo Community* (n 126); see also 'Letter to the Financial Times from SPDC MD Mutiu Sunmonu' (22 March 2012) online: static-shell.com <http://s01.static-shell.com/content/dam/shell/static/nga/downloads/pdfs/our-response/mutius-letter.pdf> accessed 10 September 2014; 'Bodo Oil Spills and Compensation' online: shell.com <www.shell.com.ng/environment-society/our-response/bodo-spills.html> accessed 10 September 2014.

128 *The Bodo Community* (n 126).

129 Leigh Day, 'London High Court Rules that Shell Nigeria Could be Legally Liable for Bunkering' (20 June 2014) online: Leigh Day <www.leighday.co.uk/News/2014/June-2014/London-High-Court-rules-that-Shell-Nigeria-could-b> accessed 10 September 2014.

130 N Jägers, K Jesse and J Verschuuren, 'The Future of Corporate Liability for Extraterritorial Human Rights Abuses: The Dutch Case against Shell' 107(4) American Journal of International Law E36, E37 (citing *Akpan v Royal Dutch Shell plc*, Arrondissementsrechtbank Den Haag [District Court of the Hague] 30 January 2013, Case no C/09/337050/HA ZA 09-1580 [ECLI-NL-RBDHA-2013-BY9854]).

131 Ibid E38 (distinguishing the Dutch scenario from that of the USA in *Kiobel* based on the unique nature of the American Alien Torts Statute, 28 USC §1350); see also A Smith, 'Shell Lied to Dutch Court about Oil Spills in Nigeria, Say Friends of the Earth' (17 November 2014) online: Newsweek <www.newsweek.com/shell-lied-dutch-court-about-oil-spills-nigeria-says-friends-earth-284900> accessed 1 April 2015.

132 Jägers et al (n 130) (citing Article 51 of the Dutch Criminal Code [Wetboek van Strafrecht]).

133 *Chevron Corp v Donziger*, 11 Civ 0691 (LAK)(SDNY 2013).

134 Ibid.

135 Ibid.

136 Mica Rosenberg, 'Chevron Wins a Round in US Suit against Lawyer in Ecuador Case' (25 April 2014) online: Reuters <www.reuters.com/article/2014/04/26/us-chevron-ecuador-appeal-idUSBREA3P00220140426> accessed 10 September 2014.

has been appealed.[137] In July 2014, 17 civil society groups filed a request to file an *amicus* pleading before the appellate court in the enforcement action, arguing that Chevron's practices, as well as the trial judge's ruling, violated the First Amendment rights of advocates, arguing that Chevron was trying to use the US legislation to intimidate and silence its critics.[138]

The original case had related to claims by people living near the site of oil excavation by Texaco, later acquired by Chevron, that they were suffering ill-health effects of environmental contamination caused by the operations there.[139] Chevron had asserted that Texaco cleaned up the area before the transfer to Chevron, which the plaintiffs dispute.[140]

Because of the allegations of fraud, however, even if enforcement is not ultimately allowed in the USA, the value of the case as precedent on this issue is likely to be somewhat limited. The plaintiffs have not limited their enforcement attempts to the USA, however, and are also attempting to enforce the judgment against Chevron holdings in Canada, Argentina and Brazil.[141] Reports suggest that Chevron will try to use the US ruling to fight enforcement actions in the other jurisdictions in which the plaintiffs are trying to collect.[142]

In the Canada enforcement action, the Ontario Court of Appeal overturned a ruling of a lower court that barred enforcement by the same group of Ecuadorian plaintiffs.[143] The court quoted a Chevron spokesman, who said, if Chevron lost, '[w]e're going to fight this until hell freezes over. And then we'll fight it out on the ice.'[144] The court responded: 'Chevron's wish is granted. After all these years, the Ecuadorian plaintiffs deserve to have the recognition and enforcement of the Ecuadorian judgment heard on the merits in an appropriate jurisdiction.'[145] The Ontario Court of Appeal, however, is not the last word on the issue, as the Supreme Court of Canada has granted Chevron leave to appeal.[146] Moreover, the timing of the two decisions suggests that the Canadian court was not influenced by the ruling in the USA.[147] In light of Chevron's stated intention of bringing the US ruling to the courts' attention in the other jurisdictions, and the ongoing nature of the litigation in both countries, it remains to be seen how much influence one will have on the other.

The Canadian case looks likely to be contentious and, as of August 2014, motions for leave to intervene were pending from the Canadian Bar Association, the US Chamber of

137 Rosenberg (n 136) 1; see *Chevron Corporation v Donziger et al*, no 14-0826-CV (2d Cir 2014); *Chevron Corporation v Naranjo*, no 14-0826 (L)(2d Cir 2014).

138 *Chevron Corporation v Hugo Gerardo Camacho Naranjo et al*, no 14-0826 online: chevrontoxico <http://chevrontoxico.com/assets/docs/2014-07-08-amazon-watch-brief.pdf> accessed 10 September 2014.

139 *Donziger* (n 133) 1.

140 Ibid.

141 Rosenberg (n 136).

142 Paul M Barrett, 'Chevron RICO Fallout: What Happens to the Losing Lawyer?' (7 March 2014) online: Businessweek <www.businessweek.com/articles/2014-03-07/chevron-rico-fallout-what-happens-to-the-losing-lawyer> accessed 10 September 2014.

143 *Yaiguaje v Chevron Corporation*, 2013 ONCA 758.

144 Ibid para 74.

145 Ibid para 75.

146 *Chevron Corporation et al v Daniel Carlos Lusitande Yaiguaje et al* (Ontario) (Civil) (By Leave) no 35682 (*Yaiguaje, SCC*), case updates, online: Supreme Court of Canada <www.scc-csc.gc.ca/case-dossier/info/dock-regi-eng.aspx?cas=35682> accessed 1 April 2015 . Oral arguments were heard in December 2014. Ibid.

147 *Yaiguaje* (n 143); *Donziger* (n 133).

Commerce, the Justice and Corporate Accountability Project and the International Human Rights Program of the University of Toronto Faculty of Law.[148]

6 Conclusions: perhaps a Dutch door?

The varying results on whether these cases can initially be brought in different jurisdictions, or enforced after an order in the original jurisdiction, coupled with the somewhat fact-specific nature of such questions, suggests more of a metaphor of a Dutch door. The top may or may not be open, while the bottom portion remains certainly closed.

What is apparent, however, is that the changing nature of corporate functioning, reach, and influence means that courts in the various jurisdictions must find a way to ensure that those who are subject to human rights or environmental abuses overseas have some way of accessing legitimate judicial proceedings to have their claims heard.[149] That need is especially compelling when those allegations arise in jurisdictions that have questionable judicial systems, or where enforcement actions in other jurisdictions are necessary. In Canada, former Supreme Court Justice Ian Binnie has spoken out on this issue, not specifically relating to the *Choc* case, but on the larger issue of corporate accountability, saying '[e]ventually, the courts are going to have to face up to the fact that in any responsible legal system people have a right to a day in court. And if the only court available is in Canada then that's where the problem should be faced.'[150]

Regardless of the ultimate outcome on the merits, the Canadian *Choc* case, for instance, is still limited in its scope, as a trial court ruling from one province within Canada, and also as based on rather specific facts. Paul Champ, a lawyer who intervened in the *Choc* case for Amnesty International, has expressed the view that, even if the *Choc* case serves as precedent that such cases can proceed to trial in Canada, the number of such cases is likely to be limited because of the costs involved and the difficulty of bringing plaintiffs forward from areas that may be affected by conflict, although he did believe there would be some similar cases.[151]

The decision is making some difference as a cautionary tale for Canadian multinational corporations that they may not be entirely protected from liability in such cases. Indeed, a number of Canadian law firms issued advisories, after the decision, for multinational corporations to address the type of conduct that could lead to such actions.[152] Some warned against the specific type of factual scenario that led the Ontario court to rule that the case against the parent could proceed. Bennett Jones, for instance, noted in its commentary:

> This decision serves as an important reminder for Canadian corporations with foreign subsidiaries. The advantages made available by incorporating foreign subsidiaries can be undermined if employees of the Canadian parent are directly involved in operating the foreign subsidiary, including developing its policies,

148 *Yaiguaje, SCC* (n 146).

149 See V Crystal, S Imai and B Maheandiran, 'Access to Justice and Corporate Accountability: A Legal Case Study of HudBay in Guatemala' (2014) 35(2) Canadian Journal of Development Studies 286–303.

150 Public Radio International, 'Guatemalan Villagers Make Long Journey to Canada in Search of Justice' (2012) online <http://culturine5.rssing.com/browser.php?indx=4035254&item=378> accessed 10 September 2014.

151 P Koven, 'HudBay Case Raises Litigation Risk for Canadian Resource Companies' (30 October 2013) online: Legal Post <http://business.financialpost.com/2013/10/30/hudbay-case-raises-class-action-risk-for-canadian-resource-companies> accessed 10 September 2014.

152 See e.g. A J Gray and J R Lambert, 'A Warning for Canadian Corporations with Foreign Subsidiaries' (30 July 2013) online: Bennett Jones <www.bennettjones.com/Publications/Updates/A_Warning_for_Canadian_Corporations_with_Foreign_Subsidiaries> accessed 10 September 2014.

> speaking on its behalf, or directly engaging in on-the-ground activities. The advantages of separate corporate personality are only enjoyed where separate corporate personality is respected in theory and practice.[153]

While this commentary relates to ensuring the distinct nature of a parent from a subsidiary for liability purposes, others warned about taking greater care to minimise the risk that subsidiaries will commit human rights or other violations overseas.[154] Gowlings suggested:

> We recommend that every company that operates outside Canada should take the following minimum steps to practice due diligence with respect to its foreign operations:
>
> - Carry out human rights, violence and corruption risks assessment that prioritize high risk geographical and functional areas.
> - Adopt a global code of business conduct and anti-corruption policy that sets a very clear tone that human rights violations, violence and bribery will not be tolerated, and provide ample and frequent training to both employees and third party intermediaries/business partners to reinforce the message.
> - Adopt specific procedures and internal systems and controls to monitor operations in foreign countries.
> - Develop processes for the effective conduct of tiered, risk-based due diligence for the retention and monitoring of third party intermediaries and business partners in foreign jurisdictions.
> - Anti-corruption due diligence should also figure prominently in any merger or acquisition activity.[155]

Even the mere possibility of success of such an action, regardless of the ultimate parameters of that possibility, may, on its own, bring about some changes in the way Canadian multinationals do business in developing countries. It is less clear, however, that the case will bring about similar changes in practices in other jurisdictions, so even that benefit is limited.

Moreover, changes in voluntary multinational practices, while important, are not enough to address the shortcomings in access to justice that can arise where abuses are nonetheless alleged. A gap remains for those cases in which allegations still emerge that a multinational corporation from one country, on its own or via a subsidiary, is responsible for human rights or environmental abuses in a developing country that does not have adequate recourse to judicial resources. It is not clear, even within Canada, that the *Choc* case opens the door to these claims far enough. Moreover, the trend in the USA actually appears to be to keep the door closed to such actions as much as possible, as evidenced by the *Kiobel* ruling, and, to a lesser extent, by the current litigation in the *Chevron* matter. This trend may ultimately influence Canada's approach, although that remains to be seen.

Because of the nature of how multinationals operate, courts and perhaps legislatures in the home jurisdictions of such companies must work towards avoiding impunity for human

153 Gray and Lambert (n 152); see also R Williams and T Bottomer, 'Dodging the Corporate Veil – Recent Attempts to Hold Companies Liable for the Actions of their Foreign Subsidiaries' The Resource online: BLG Energy Law Blog (January 2015) <http://blog.blg.com/energy/Lists/Posts/Post.aspx?ID=289&utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original> accessed 1 April 2015 (describing two cases filed after the *Choc* ruling, with plaintiffs apparently inspired by that case to pursue direct actions against parent corporations, entirely avoiding the issue of the corporate veil – both actions have been filed in British Columbia in Canada).

154 See e.g. Gowlings, 'Knowledge Centre: Enhanced Liability abroad for Canadian Corporations' (August 2013) online: <http://m.gowlings.com/knowledgecentre/article.asp?pubID=2975> accessed 10 September 2014.

155 Ibid.

rights and environmental abuses overseas. This article does not engage with the issue of exactly how these mechanisms must look, as the threshold issue of the necessity of such mechanisms at all has not been accepted yet in most jurisdictions. There has, however, been long-term academic discussion of how courts might tailor existing doctrines to better allow for access to justice in such cases, and opinions vary widely as to how and whether this can be accomplished.[156] At the very least, the current hurdles in jurisdiction may need to be reassessed, and some of the recent cases in this area suggest that courts are doing just that, at least in some instances. Much more needs to be done, but with some of the recent rulings across jurisdictions, there is growing evidence that some courts may at least be leaving the door unlocked for some of these cases.

156 See e.g. Nwapi (n 6) (advocating for application of the jurisdiction by necessity doctrine for some such cases and providing a useful discussion of other possible scenarios); Patrick Macklem, 'Corporate Accountability under International Law: The Misguided Quest for Universal Jurisdiction' (2005) 7(4) International Law FORUM du droit international 281 (writing '[s]educed by cosmopolitan fantasies of a truly global legal order righteously meting out justice against lawless transgressors, the international legal imagination has begun a misguided and risky quest for universal jurisdiction over human rights violations by multinational corporations').

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Enhancing transparency through company law reform in China

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Abstract

A growing awareness of corporate social responsibility (CSR) is always reflected by an increase in the number of CSR or sustainability reports published, as well as in the provision of CSR-related information. The growing importance of socially responsible investment and of the media are converging, and an increasing awareness of companies' social, ethical and environmental performance calls for greater transparency in reporting. Corporate disclosure is one of the most common means of ensuring adherence to corporate governance principles such as fairness and transparency. This issue is particularly important for China, where guanxi and government control are regarded as key elements for business transactions. This article sets out to explore the emerging practice of CSR reporting in China to examine whether current practice is motivated by the purpose of discharging accountability to relevant stakeholders, and also whether it is helpful to transplant the UK's 'strategic report' system to China. It is salient to discuss why the CSR reporting system is important to China in order to promote CSR and a harmonious society, and how to enforce the scheme by mandatory regulations and voluntary guidelines. If a CSR reporting system is established, there is likely to be resistance to major regulatory changes. It would be desirable to maintain a balance between efficient disclosure and increased burdens for companies in order to achieve the ultimate purpose of boosting the competitive advantages of companies through increased transparency via corporate disclosure.

1 Introduction

Over the last three decades China has achieved unprecedented economic growth as 'a champion of a state-led growth model'.[1] China represents an important and contemporary environment for research, practice and legislation for CSR by virtue of the distinctive roles of its government and regulation, and the globalisation of the Chinese economy. Investigation of Chinese companies' engagement with CSR, in comparison with the overall discussion and literature related to CSR in general, is rather limited, and the idea of CSR in China is comparatively new to companies and related academic research. China is infamous for corporate scandals such as sweatshops, environmental pollution problems,

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1 Benjamin van Rooij, 'Inaugural Lecture: The People's Regulation: Citizens and Implementation of Law in China', 2011, University of Amsterdam.

poor working conditions and, especially recently, for food safety and product safety issues, with the more than 300,000 victims from the SanLu baby milk scandal as an example. Enforcement approaches that have been the subject of international academic discussion include: CSR-related legislation within Chinese company law (CCL);[2] the Code of Corporate Governance for Listed Companies in China;[3] administrative measures on information disclosure of listed companies and the Listing Rules of the Stock Exchange 2010; administrative organisations;[4] and other laws such as the Chinese Employment Contract Law 2008.[5] Among these approaches to enforcing CSR measures within corporate strategies, directors' duties towards stakeholders and mandatory information disclosure have been regarded as two direct measures in corporate law which can act to embed the legislative approach on CSR into corporate behaviours and decisions through progressive corporate law. This article will focus on information disclosure, especially within a legal context, to explain the uniqueness, characteristics, content and purpose of the CSR information disclosure system in China.[6]

As one of the most common means of achieving transparency, corporate disclosure is first emphasised by using the analogy that 'sunshine is said to be the best of disinfectants; electronic light the most efficient policeman'.[7] It is regarded as a corporate governance principle that stakeholders should have access to relevant, sufficient and reliable information on a timely and regular basis.[8] Disclosure assists in making the securities market more transparent, and it is effective in maintaining the confidence of investors who trade on the basis of securities information. Securities markets have always regarded information disclosure as a fundamental issue.[9] Furthermore, corporate disclosure also has the effect of raising corporate governance standards with the purpose of building business aims and principles, since it enhances accountability.[10] The Chinese Corporate Governance Code 2002, in line with the Organization for Economic Co-operation and Development (OECD) Principles of Corporate Governance, included 'information disclosure and transparency' as a chapter in itself and urged listed companies to 'truthfully, accurately, completely and in a timely manner disclose information as required by laws, regulations and the company's articles of association'.[11] However, absent a corporate governance code after 2002, there has been little up-to-date discussion on mandatory information disclosure of CSR issues, either in China or generally.[12] As a result, it is important to study CSR disclosure within mandatory aspects in CCL to fill the literature gap.

2 See Article 5 CCL 2006.

3 See ss 81–8 Code of Corporate Governance for Listed Companies in China.

4 Environmental Protection Agency, the Equal Employment Opportunity Commission, the Occupational Safety and Health Administration and the Consumer Product Safety Commission.

5 Ss 12, 14 and 15 Chinese Employment Contract Law 2008.

6 For discussions on uniqueness of corporate governance and CSR, see H Chen and X Wang, 'Corporate Social Responsibility and Corporate Financial Performance in China: An Empirical Research from Chinese Firms' (2011) 11 Corporate Governance 361; J Zhao, 'Promoting Stakeholders' Interests in the Unique Chinese Corporate Governance Model: More Socially Responsible Corporations?' (2010) International Company and Commercial Law Review 373.

7 L D Brandeis, *Other People's Money and How the Bankers Use It* (National Home Library Foundation 1933) 62.

8 Principle IV.D, *Chinese Securities Regulatory Committee, OECD–China Policy Dialogue on Corporate Governance: Corporate Governance of Listed Companies in China; Self-Assessment by the China Chinese Securities Regulatory Committee* (OECD 2011).

9 J Fu, *Corporate Disclosure and Corporate Governance in China* (Kluwer Law International 2010) 23–4.

10 A Cadbury and I M Millstein, 'The New Agenda for ICGN, Discussion Paper No 1' for the International Corporate Governance Network 10th Anniversary Conference, 13 July 2005, London <www.icgn.org/403>.

11 S 87 Code of Corporate Governance for Listed Companies in China.

12 D G Barakas and A M Brown, 'Corporate Social Reporting and Board Representation: Evidence from Kenyan Banking Sector' (2008) 12 Journal of Management and Governance 309.

Countries with emerging markets, such as China, always suffer more with social and environmental problems faced by multinational and domestic companies. These problems include workplace issues, which cover an expanding range of topics (such as labour standards), marketplace issues (most notable in emerging markets is the integrity of product manufacturing and quality) and environmental issues (to promote the sustainability of the companies). The growing importance of socially responsible investment and of the media are converging, and an increasing awareness of companies' social, ethical and environmental performance calls for greater transparency in reporting.[13] Transparency has been regarded as a critical component of corporate governance regimes, and openness can be achieved through clear disclosure and reporting and through engagement and dialogue among directors, shareholders and stakeholders. CSR-related information disclosure makes it possible for profitable companies to show that their business operations and decisions have been performed within the norms of society, and demonstrate that they are fully aware of the costs of breaching society's expectations.[14] Legislation in mandating disclosure of certain pieces of CSR-related information in different corporate disclosure documents – such as the periodic disclosure documents, the financial statement and the accompanying notes, the annual report or the corporate governance report, and also certain continuous disclosure documents – will help multi-stakeholder governance and corporate suitability.[15]

The paper will begin with a discussion of the CCL system in order to better understand how CSR fits into the current international regime. Special attention will be paid to information disclosure requirements with a discussion of the existing rules and the inadequacy of mandatory requirements for CSR-related information disclosure within CCL. Thereafter, the question arises of how to establish an effective and efficient CSR information disclosure system in China, incorporating both mandatory and voluntary elements. The mandatory origins will be discussed with broader corporate objective requirements within Chinese Company Law 2006. This article then sets out to explore the emerging practice of CSR reporting in China to examine whether current practice is motivated for the purpose of discharging accountability to relevant stakeholders and whether it is helpful to transplant the international code and the strategic report requirement embedded in the UK Companies Act 2006. Two-way communication within a reporting system with strong government interference will be suggested at the end of the article as a way to make information disclosure more enforceable and efficient in China.

2 Regulation of CSR and transparency requirements under CCL

A sound legal system with efficient enforcement measures is necessary for CSR enforcement in order to protect the interests of various non-shareholder stakeholders.[16] Chinese law does provide compulsory requirements for CSR regarding fundamental and instrumental CSR issues, with a wide range of standards in place concerning environmental

13 N Dando T Swift, 'Transparency and Assurance: Minding the Credibility Gap' (2003) 44 Journal of Business Ethics 195, 195–6.

14 K Bewley and Y Li, 'Disclosure of Environmental Information by Canadian Manufacturing Companies: A Voluntary Disclosure Perspective' (2000) 1 Advances in Environmental Accounting and Management 201, 203.

15 See D G Szabo, 'Disclosure of Material CSR Information in the Periodic Reports – Comparison of the Mandatory CSR Disclosure Systems for Listed Companies in the EU and the US' Nordic and European Company Law Working Paper 10-20 (2011) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1927232>.

16 OECD, 'Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission' (OECD 2011) 95.

protection, product quality safety and employees' interests.[17] Mechanisms that protect the interests of various stakeholders are defined in departmental laws including Chinese Company Law 2006, the Law on Commercial Banks 1995 (amended 27 December 2003), the Law of Employment Contract of China 2008, the Securities Law 2006 and the Enterprise Bankruptcy Law 2007.[18] At the company law level, the old CCL launched in 1994 did not explicitly make reference to CSR.

Legislators of the new CCL incorporated a CSR element directly into Article 5 of CCL 2006, stating that:

> a company must, when engaging in business activities, abide by the laws and administrative regulations, observe social morals and business ethics, be in integrity and good faith, accept regulation of the government and the public, and undertake social responsibilities.

This is a broad legislative attempt to clarify that corporate objectives, apart from making profits for shareholders, also include social and environmental aspects. It is implied that apart from the interests of shareholders, interests of employees, creditors and other stakeholders should also be considered for companies' public social interests. Therefore, when company directors and supervisors pursue the interests of their shareholders, they also have to be socially responsible to internal and external stakeholders. Moreover, contemporary modern terms such as 'business ethics' and 'social responsibilities' were introduced into the general provisions to make them consistent with the goal of sustainability within the wider political policy of a harmonious society.[19] In addition to Article 5, which requires that directors go beyond economic and legal responsibility to encompass social and philanthropic responsibility, the rights of employees, as primary internal stakeholders, were also emphasised in the new CCL 2006,[20] which may help to illustrate the approach underlying Article 5. Moreover, in terms of the legislative tenets, Article 1 of CCL 2006 makes it clear that this legislation was enacted in order to:

> standardise the organisation and activities of companies, to protect the legitimate rights and interests of companies, shareholders and creditors, to maintain socio-economic order and to promote the development of the socialist market economy.[21]

The interests of creditors, as primary external stakeholders, were explicitly adopted, along with the interests of shareholders and the company itself.

In spite of the country's impressive economic growth, it is common knowledge that China has weak legal institutions and poor protection of property rights, including intellectual property, and its capital market is characterised by prevalent earnings

17 OECD (n 16).

18 See Articles 1 and 5 CCL 2006; Articles 6, 29–33 Law on Commercial Banks 1995; Articles 2, 5, 17, 21 51 and 87 Law of Employment Contract of China; and Articles 1, 5 and 6 Enterprise Bankruptcy Law 2007.

19 For discussions on linkage between the harmonious society and CSR, see K H Darigan and J E Post, 'Corporate Citizenship in China: CSR Challenges in the "Harmonious Society"' (2009) 35 Journal of Corporate Citizenship 39; D Karlsson, *Corporate Social Responsibility: A Tool for Creating a Harmonious Society in China* (European Institute for Asian Studies 2011); G See, 'Harmonious Society and Chinese CSR: Is There Really a Link?' (2008) 89 Journal of Business Ethics 1.

20 Articles 17, 18, 51 and 117 CCL 2006.

21 Article 1 CCL 2006.

manipulation and high stock return synchronicity.[22] Enforcement normally refers to the implementation of national legislation together with international law that China is bound by, and international law and treaty obligations are thought to prevail if there is a conflict between domestic law and an obligation from an international treaty which binds China by law.[23] Although it is positive that the government is making initial efforts to realise the importance of CSR and make it legitimate for directors to consider their responsibility beyond shareholder value maximisation, it is still important to identify the approaches by which the Chinese government may enforce these rules.

The proper implementation and enforcement of CSR-related laws seems to be the future of CSR, with government interference, supervision and promotion needed in order to turn CSR-related laws in CCL into law-in-action rather than law-in-books. Strict information disclosure requirements on listed companies are an important way of enforcing CSR-related legal requirements and ensuring that stakeholders are informed of socially responsible corporate actions and decisions. However, the statistics do not reflect a very positive trend.

In 2008, it was estimated that among 1625 listed companies in China,[24] only 162 of the companies listed on the Shenzhen Stock Exchange and 290 on the Shanghai Stock Exchange disclosed their reports.[25] CSR reports in China are not typically audited and the quality of the CSR disclosure tends to be poor, as illustrated by a report from SynTao Sustainability Solution, a CSR consulting firm.[26] It is reported that only 5 per cent of the 535 CSR reports surveyed in 2009 were independently audited, and over 50 per cent of the reports contained no more than 10 pages.[27] However, the situation has improved since then as indicated from KPMG statistics in 2011 regarding the largest companies in China.[28] China was new to this survey in 2011 and was in a full-out sprint to catch up with the traditional leaders in the field, with almost 60 per cent of China's largest companies reporting, according to corporate responsibility metrics. Again, another study by SynTao also showed improvements in CSR reporting based on data collected in 2012–2013.[29] There was a total of 1705 CSR reports released in 2012. The overall number of reports increased by over 70 per cent compared with the previous year.[30] This was confirmed by the KPMG

22 See F Allen, R Chakrabarti, S De, J Qian and M Qian, 'Law, Institutions and Finance in China and India' in B Eichengreen, P Gupta and R Kumar (eds), *Emerging Giants: China and India in the World Economy* (OUP 2010) 125. See also R Morck, B Yeung and W Yu, 'The Information Content of Stock Markets: Why Do Emerging Markets Have Synchronous Stock Price Movement?' (2000) 58 Journal of Financial Economics 215.

23 K Buhmann, 'Corporate Social Responsibility in China: Current Issues and their Relevance for Implementation of Law' (2005) 22 Copenhagen Journal of Asian Studies 62, 78; J Chen, Y Li and J M Otto, *Implementation of Law in the People's Republic of China* (Kluwer 2002).

24 Data from China Securities Regulatory Commission <www.csrc.gov.cn/pub/zjhpublic/G00306204/zqscyb/200901/t20090120_108744.htm>.

25 OECD, 'Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission' (OECD 2011) 102.

26 All documents can be downloaded via <www.syntao.com/Resources/SustainabilityReport_Show_CN.asp>.

27 SynTao China Sustainability Reporting Centre, *A Journey to Discover Values: A Study of Sustainability Reports in China* (SynTao 2009).

28 KPMG, *KPMG International Survey of Corporate Responsibility Reporting 2011* (KPMG 2011).

29 SynTao China Sustainability Reporting Centre, *A Journey to Discover Values: A Study of Corporate Social Responsibility Reports in China* (SynTao 2012–2013).

30 Ibid 2.

statistics in 2013 that 75 per cent of companies report on their CSR.[31] However, the percentage of reports that were independently audited dropped to 3 per cent in 2012. Nevertheless, it is predicted that China will enjoy a widespread reporting system in the future.[32] This improvement does make mandatory information disclosure for CSR issues possible and necessary. Mandatory information disclosure for listed companies on social and environmental issues can be accommodated as one of the most effective ways to facilitate CSR in action and change the current state of corporate reporting on CSR issues.

3 Normative justification for regulating CSR-related information disclosure

CSR-related reporting, while not mandatory in most countries, has been accommodated and adopted in many corporations around the world. There are a variety of competing global standards for non-financial reporting, such as the Global Reporting Initiative (GRI)[33] and the UN Global Compact.[34] Although it can be initially traced back to the 1970s,[35] CSR reporting re-emerged from the mid-1990s onwards in research and practice in the fields of corporate governance, accounting and auditing. The concepts of CSR reporting or CSR-related information disclosure reporting have also been referred to as sustainability reporting, social responsibility accounting,[36] social accounting[37] and corporate social disclosure,[38] and they have been popularised using the acronym SEAAR (social and ethical accounting, auditing and reporting).[39] According to the *KPMG International Survey of Corporate Responsibility Reporting 2013*, the most popular terms used are sustainability report (43 per cent), CSR report (25 per cent), corporate responsibility report (14 per cent) and sustainable development report (6 per cent).

Corporate responsibility reporting has established its position as the *de facto* law for business, delivering a compelling insight into the expectations that companies face.[40] Based on the *KPMG International Survey of Corporate Responsibility Reporting 2013* for the G250 companies, drawn from the Fortune Global 500 List and representing more than a dozen industry sectors, there has been an upward trend in CSR reporting. It is said that CSR reporting sees exceptional growth in emerging economies.[41] The corporate report grew by 53 per cent in India, 46 per cent in Chile and 16 per cent in China. An expanded social disclosure generally starts with information on the products a company produces, extending to the company's law compliance structure, its domestic and global labour practices, its supplier/vendor standards and global environmental effects.[42] The attention of legislators focuses on making CSR mandatory, embedded in corporate strategies within the companies, and this includes mandatory information disclosure in company law through reviews or

31 KPMG, *KPMG International Survey of Corporate Responsibility Reporting 2013* (KPMG 2013) 13.

32 KPMG (n 28) 10.

33 For more information, see the official website <www.globalreporting.org/Pages/default.aspx>.

34 For more information, see the official website <www.unglobalcompact.org>.

35 A R Belal, *Corporate Social Responsibility Reporting in Developing Countries: The Case of Bangladesh* (Ashgate 2008) 6.

36 M R Mathews, 'A Suggested Classification for Social Accounting Research' (1984) 3 Journal of Accounting and Public Policy 199.

37 R Gray, 'Current Developments and Trends in Social and Environmental Auditing, Reporting and Attestation: A Review and Comment' (2000) 4 International Journal of Auditing 247.

38 A R Belal, 'A Study of Corporate Social Disclosures in Bangladesh' (2001) 16 Managerial Auditing Journal 274.

39 C Gonella, A Piling and S Zadek, 'Making Values Count: Contemporary Experience in Social and Ethical Accounting' (ACCA 1998).

40 KPMG (n 28) 2.

41 KPMG (n 31) 10.

42 C A Williams, 'The Securities and Exchange Commission and Corporate Social Transparency' (1999) 112 Harvard Law Review 1197, 1201–2.

reports which should be available to shareholders, stakeholders and even the public at large.[43] Meanwhile, public companies, in response to increasing public concerns about corporate social performance and social responsiveness, are becoming increasingly open about the social and environmental impacts of their business activities, especially with the growing number of multinational corporations and their acceptance and awareness of global CSR reporting standards.[44]

CSR reporting is increasingly regarded as a result of the debate over corporate governance globally with the purpose of promoting transparency and accountability of corporations. It is concluded that increased transparency in corporate disclosure, especially in the aftermath of the financial crisis, will boost the competitive advantages of companies which aim for it.[45] Our results show that the number of CSR reports significantly increased after the crisis. It was found through empirical research that the economic crisis has affected the strategy on CSR reporting. Rather than reducing the number of reports published, in fact, the crisis has actually increased the trend for reporting.[46] Fitting into the enlightened requirements of corporate objectives, two legislative attempts always go hand in hand in corporate law to achieve these goals for the long-term interests of corporations, namely directors' duties and mandatory information disclosure for public companies.[47] Explicit recognition of the interests of stakeholders should be made a legal requirement – or at least it should be legitimately approved or explicitly permitted under company law through provisions related to directors' duties, shareholders' rights, stakeholders' rights (the rights of creditors and employees are most often discussed), and information disclosure requirements.[48] While directors are given legitimacy to consider the interests of stakeholders, it is logical to understand the system as the external reporting of ethical, social and environmental aspects of a corporation, while corporations try to achieve information disclosure aspects beyond the traditional boundaries by providing a financial account to the shareholders under the assumption that companies have and will carry out responsibilities beyond making profits.

In recent years, with the more transparent media disclosure, we have witnessed many corporate scandals in China, while the whole of society, especially manufacturers, has to bear the social cost as a result of these scandals. As well as getting attention from

43 Szabo (n 15) 1–2.

44 S Chen and P Bouvain, 'Is Corporate Responsibility Converging? A Comparison of Corporate Responsibility Reporting in the USA, UK, Australia and Germany' (2009) 87 Journal of Business Ethics 299, 300.

45 O Aiyegbayo and C Villiers, 'The Enhanced Business Review: Has It Made Corporate Governance More Effective?' (2011) Journal of Business Law 699, 720.

46 A Garcia-Benau, L Sierra-Garcia and A Zorio, 'Financial Crisis Impact on Sustainability Reporting' (2013) 51 Management Decision 1528.

47 A good example would be ss 172 (1) and 414 UK Companies Act 2006, and ss 74 and 66(2)(c) Company Law of the Republic of Indonesia 2007.

48 For example, see D McBarnet, A Voiculescu and T Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (CUP 2007); K Buhmann, 'Corporate Social Responsibility: What Role for Law? Some Aspects of Law and CSR' (2006) Corporate Governance 188; C Villiers, 'Corporate Law, Corporate Power and Corporate Social Responsibility' in N Boeger, R Murray and C Villiers (eds), *Perspectives on Corporate Social Responsibility* (Edward Elgar 2010); J Zhao, 'Promoting More Socially Responsible Corporations through UK Company Law after the 2008 Financial Crisis: Turning of the Crisis Compass' (2011) 22 International Company and Commercial Law Review 275; P Puri, 'The Future of Stakeholder Interests in Corporate Governance' (2010) 48 Canadian Business Law Journal 427; J E Kerr, 'Sustainability Meets Profitability: The Convenient Truth of How the Business Judgement Rule Protects a Board's Decision to Engage in Social Entrepreneurship' (2007) 29 Cardozo Law Review 623; R I Patel, 'Facilitating Stakeholder-Interest Maximization: Accommodating Beneficial Corporations in the Model Business Corporation Act' (2010) 23 St Thomas Law Review 135; A Mickels, 'Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporate with Director Fiduciary Duties in the US and Europe' (2009) 32 Hastings International and Comparative Law Review 271.

government, media, business and society, corporate social reporting is also becoming an increasing concern for academics from disciplines such as law, accounting, corporate governance and strategic management.[49] The legal responses to CSR and inadequate protection for various stakeholders have to be understood with reference to China's unique corporate governance and legal system, with its singular legislative, litigation and enforcement procedures. As non-financial CSR reporting is usually prepared on a voluntary basis, this begs the question of whether it is useful and possible for directors of listed companies to exploit annual reports as the most direct and enforceable way to legitimise CSR conduct as a complementary practice to promote the reputation and trustworthiness of Chinese companies and products that are made in China. This seems a rational and efficient way for China – a country with long-term coexistence of administrative corporate governance and economic corporate governance in which government could intervene with the business decision-making process by administrative means – to enforce CSR, allowing less unpoliced discretion for company decision-makers. Shareholders and other stakeholders in China who shoulder greater political or social risks will find the disclosed information useful, informing them what the company has done to avoid negative CSR-related shocks and scandals. It also fits within the business case for CSR to enhance the corporation's legitimacy and reputation through disclosure of information about CSR in order to illustrate that its operations are consistent with social norms and expectations.[50]

4 The current regulatory framework for CSR reporting in China: problems, challenges and opportunities

Looking at the main legislation regulating public companies, the mandatory requirements on CSR information disclosure are unsatisfactory. According to CCL 2006[51] and the Chinese Securities Law 2006,[52] listed companies are required to disclose regular reports, in the form of a financial report, an accounting report, annual reports, half-year reports and quarterly reports, on a timely basis. However, the content of these mandatory reports has always focused on the financial aspects of the company. For example, a company is required by CCL 2006 to formulate a financial report and have it checked by an accounting firm according to the relevant laws, administrative regulations and the provisions of the treasury department of the State Council.[53] According to the Securities Law 2006, listed companies are required to submit interim reports which contain information including financial accounting reports, business reports, major lawsuit(s), and changes in shares and corporate bonds.[54] According to CCL 2006, annual reports are also required to disclose information including: company profile; financial accounting reports; business reports; profiles of

49 See A A Ullmann, 'Data in Search of a Theory: A Critical Examination of the Relationship among Social Performance, Social Disclosure, and Economic Performance of US Firms' (1985) 10 Academy of Management Review 540; R Gray, R Kouhy and S Lavers, 'Corporate Social and Environmental Reporting: A Review of the Literature and a Longitudinal Study of UK Disclosure' (1995) 8 Accounting, Auditing and Accountability Journal 47; D M Patten, 'Media Exposure, Public Policy Pressure, and Environmental Disclosure: An Examination of the Impact of Tri Data Availability' (2002) 26 Accounting Forum 152; W G Blacconiere and W D Northcut, 'Environmental Information and Market Reactions to Environmental Legislation' (1997) 12 Journal of Accounting, Auditing and Finance 149.

50 A B Carroll and K M Shabana, 'The Business Case for Corporate Social Responsibility: A Review of Concept, Research and Practice' (2010) International Journal of Management Review 86, 99–100.

51 Articles 33, 97, 145, 164 and 165 CCL 2006.

52 Articles 14, 52, 65, 66 and 68 Chinese Securities Law 2006. Of course, there are also related requirements in Administrative Measures on Information Disclosure by Listed Companies and the Measures for the Administration of Material Asset Reorganisation by Listed Companies at non-government legislation level.

53 Article 164 CCL 2006.

54 Article 65 Chinese Securities Law 2006.

directors, supervisors and senior management personnel and their shareholdings; existing shares and corporate bonds; and the actual controlling party of the company.[55] These mandatory information disclosure requirements have focused exclusively on the financial aspects of companies while information about non-financial issues, such as environmental matters, employees' interests, human rights issues, and social and community issues, have been ignored, although these have been accommodated in legislation in other jurisdictions.[56]

Despite the lack of mandatory requirements for reporting of social and environmental issues in CCL 2006 or Securities Law 2006, CSR disclosure initiatives were launched by government sectors, government agencies and stock exchanges to enhance the effectiveness of Article 5 in the new CCL 2006 by accommodating CSR into corporate objective stipulation. This is regarded as a result of identifying sustainable development as a priority national strategy and the Chinese government has made great efforts to encourage Chinese enterprises to become more socially and environmentally responsible to their stakeholders. At the national level, the State-owned Assets Supervision and Administration Commission (SASAC) released a directive entitled 'Guidelines to the State-Owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities' in January 2008, encouraging fulfilling CSR 'so as to realise coordinated and sustainable development of enterprises, society and environment in all respects'.[57] In order to make the CSR information mechanism effective and efficient, regular communication and dialogue are also explicitly required of the state-owned enterprises (SOEs) to enable their stakeholders to provide feedback and give their responses speedily and 'all the information and feedback should be publicised to receive supervision from stakeholders and society'.[58] Despite the fact that this requirement for non-financial information disclosure is only limited to SOEs in China, it is a valuable legislative process for introducing a CSR information-releasing system and a CSR communication/dialogue mechanism. These two systems can be regarded as two fundamental bases to help the mandatory information disclosure work efficiently with the regulation of corporate law. They ensure that the corporations are disclosing appropriate and accurate information for shareholders and stakeholders on their social and environmental decisions and corporate actions.

At the level of stock exchanges, it is worth mentioning that both the Shenzhen Stock Exchange and the Shanghai Stock Exchange have also taken the initiative in promoting social and environmental disclosure, releasing the 'Shenzhen Stock Exchange Social Responsibility Instruction to Listed Companies' in 2006, the 'Guidelines on Environmental Information Disclosure for Listed Companies of the Shanghai Stock Exchange' in 2008, and the 'Notice on Strengthening Listed Companies' Assumption of Social Responsibility' in 2008. These guides were introduced with the purpose of 'achieving scientific development, building a harmonised society, advancing towards economic and social sustainable development and promoting corporate social responsibility'.[59] As for the information disclosure requirement, stakeholder groups, including creditors, suppliers and customers, were explicitly mentioned in the Shenzhen Stock Exchange 'Social Responsibility Instruction to Listed Companies' when discussing information disclosure requirements that were not solely for shareholders. It is stipulated that companies shall

55 Articles 65–8 Chinese Securities Law 2006.

56 For example, the UK Companies Act 2006 and Indian Companies Act 2013.

57 See State-owned Assets Supervision and Administration Commission, 'Guidelines to the State-Owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities', preface.

58 Ibid s 18.

59 Article 1 'Shenzhen Stock Exchange Social Responsibility Instruction to Listed Companies 2006'.

'inform the creditors in a timely manner of the material information relating to the creditors' rights and interests'[60] and 'keep confidential the personal information of their suppliers and customers and, without authorization or permission, may not use or sell such information for profit'.[61] According to the 'Notice on Strengthening Listed Companies' Assumption of Social Responsibility of Shanghai Stock Exchange in 2008', all listed companies are encouraged to enhance their own CSR awareness by developing a strategic plan on CSR-related issues for their corporate operations and they may disclose the goals and achievements of their CSR activities and annual social responsibility reports through announcements posted temporarily on the Shanghai Stock Exchange website.[62]

Regulatory attempts have also come from a provincial level, such as the 'Guidelines for Corporate Environmental Reports of Shandong Province 2008', 'Guidelines for CSR Reports for Industrial Enterprises of Anhui Province 2013', and 'Guidelines for CSR Reports for Industrial Enterprises of Shanxi Province 2013'. These guidelines will normally have an impact on companies registered in a province, although they will have limited influence on listed companies. Taking the guidelines for Shanxi Province as an example, it is stipulated, when discussing content of a CSR report, that the CSR information needs to be true and accurate, and that product promotion is not exaggerated, false, or misleading to the public.[63]

From the discussions above, it can be seen that Chinese government agencies, stock exchanges and local governments have introduced various CSR rules and norms about information disclosure. These regulations are issued with the consistent positive purpose of promoting CSR practice in China. However, different polices sometimes also have negative impact by requiring companies to prepare a lot of repetitive work in terms of CSR reports, involving unnecessary burdens and costs. The disadvantages of scattered and dispersed information discourse may be improved by setting minimum mandatory CSR reporting requirements for listed companies in CCL in order to unify basic standards to achieve multi-stakeholder engagement and corporate accountability.

Despite the problems of possibilities of repetitiveness and the time and money-consuming processes, it is not the intention of the author to criticise this hybrid regulatory framework, which works in the short term in China (on the contrary, the author actually thinks that it contains the seeds of a unique Chinese case, which will be discussed in section 6). However, the incomplete and unbalanced regulatory documents from various sources may also be confusing and misleading. For example, one company listed in Shenzhen Stock Exchange could be subject to guidelines from Guangdong Province, the Shenzhen Stock Exchange and SASAC all at the same time, and from the Ministry of Environmental Protection regarding environmental issues. The process of producing various documentations is inefficient, complicated and expensive. It also has a negative effect on promoting China as an attractive place for international investors. Therefore, considering that the Chinese government and stock exchanges and other regulators have launched an unprecedented number of CSR initiatives in recent years, rather than introducing additional regulations for CSR information disclosure, it is more sensible to consider the issue of how to make these hybrid regulatory regimes from sources at different levels work in a more effective and structured manner. A mandatory information disclosure

60 Article 12 Shenzhen Stock Exchange Social Responsibility Instruction to Listed Companies 2006.

61 Ibid Article 25.

62 S 3 Notice on Strengthening Listed Companies' Assumption of Social Responsibility of Shanghai Stock Exchange 2008.

63 S 5.3 Guidelines for CSR Reports for Industrial Enterprises of Shanxi Province 2013.

requirement on social, environmental and human rights issues for public companies in CCL will set the minimum standard for CSR information disclosure. This requirement on listed companies will partly achieve the legislative intention for corporate objectives embedded in Article 5 of CCL 2006. This will definitely help promote the long-term interests of companies through the harmonious society political policy. The proposed legislation may also reduce information asymmetry if the reports are informative about firms' social and political risk, and therefore help investors to assess a firm's future prospects by helping them assess a firm's political or social risks and increasing analysts' coverage.[64] The minimum requirement, together with regulations from other sources, will establish a hybrid regulatory framework on CSR information disclosure.

Besides, based on a study from the Chinese Academy of Social Science in 2011 on CSR reporting among listed companies in 2010, it appears that CSR-related reports are delivered in various ways. Regarding the presentation of the report, 99.1 per cent of the reports were delivered as separate documents. In terms of the degree of detail in the report: 38.2 per cent of the reports are less than 10 pages long; while 10.8 per cent of the reports are 31 to 50 pages long; and only 3.2 per cent of the reports are more than 90 pages long. Indeed, more lengthy reports do not necessarily mean more informative reports. However, variations in lengths of the reports will make the quality and scope of the disclosure differ dramatically. Moreover, the titles of the reports are also varied, they range from 'CSR Report' or 'Sustainability Report' to 'Corporate Citizenship Report' and 'Corporate Environmental Report'. These different titles may lead to differences in terms of the content of the reports.[65] This survey revalidated the importance of primary arguments about combined regulatory documents in terms of the nature and scope of these materials, which must work together coherently with disclosure regulations regarding non-financial issues and social, environmental and governance performance. However, a distinct problem revealed by the survey was the irregular nature and different scope of corporate reports on CSR issues. What the Chinese regulatory framework needs is a mandatory requirement for public companies to produce reports on both financial and non-financial aspects of corporate behaviours and decisions with clear and enforceable scope for non-financial reports. In principle, the proposed legislation should adopt CSR elements in order to promote sustainability of the company and satisfy the corporate objectives set out in CCL 2006.

5 Learning from legislative experiences of information disclosure on social and environmental issues from the UK

The direct transplantation of foreign law, including laws on information disclosure requirements, always needs to ensure that the new system fits into the cultural, legal, historical and political environment of China. Corporate social and environmental disclosure has become an important component of efficient CSR implementation. If there are not enough incentives for companies to report on their CSR impact in a voluntary manner based on market forces, the local government can make it a legal requirement for companies to produce these reports through corporate law, stock-listing regulations, tax law, pension fund regulations or even separate compulsory disclosure laws, setting precise standards for corporate reporting including requirements for lists of metrics, formats for

64 M Huang, J Shi and Y Wang, 'The Effect of Mandatory CSR Disclosure on Information Asymmetry: Evidence from a Quasi-natural Experiment in China' paper presented at Asian Finance Association Conference 2013 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2206877> 4–5.

65 Research Centre for Corporate Social Responsibility of the Chinese Academy of Social Science, *General Overview of CSR Reporting in China* <www.cass-csr.org/index.php?option=com_content&module=30&sortid=44&artid=300>.

reports and the frequency of reporting.[66] In order to make this legal system complete and enforceable, the information disclosed should be calculated, evaluated and studied by government agencies or independent third parties. Additionally, there should be stipulated mandatory sanctions for failures to report any of these compulsory data.[67]

Based on the data produced by the *KPMG International Survey of Corporate Responsibility Reporting* 2011 and 2013,[68] more than 90 per cent of listed companies produce a corporate report and the average quality of reports of UK companies is scored at 76; that is better than France, Germany, Japan and the USA, while Chinese companies scored lower than all of these with a score of 39.[69] The most distinctive achievement of the UK is its near unanimous adherence to corporate responsibility – 100 per cent in 2011. From the side of the government, the UK Department for Business, Innovation and Skills consulted on improving the quality of narrative reporting by quoted companies in their annual reports, including a proposal for listed companies to disclose the proportion of women on their boards and in the company. This reputable CSR information disclosure record is, in the opinion of the author, in a way related to the mandatory requirements on strategic reporting in the Companies Act 2006. While there is a legal requirement on information disclosure, directors will voluntarily also consider producing reports on social, environmental and human rights issues. It will also make the directors consider preparing a CSR report, and affect the content of the directors' annual report. Companies may also choose to cross-refer to their CSR report from their directors' report and strategic report.[70]

UK company law has gone through a series of reforms since 1995 with the adoption of the legislative principle of the enlightened shareholder value principle (ESVP),[71] involving elements of social responsibility and stakeholderism and including the legislative adoption within company law of information disclosure regarding non-financial issues. Corporate disclosure has long been regarded as an important way of enhancing corporate accountability and improving the transparency of corporate activities. In light of the growing awareness of long-term development and stakeholder considerations, there has been an increasing demand for corporations to produce reports detailing their commitment to social and environmental issues. A significant modification in the UK Companies Act 2006 was the introduction of the business review as the replacement of the operating financial review (OFR),[72] in line with the minimum requirements of the EU Accounts Modernisation Directive 2003 which called for a company's annual report to include 'both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters

66 C Noronha, S Tou, M I Cynthia and J J Guan, 'Corporate Social Responsibility Reporting in China: An Overview and Comparison with Major Trends' (2013) 20 Corporate Social Responsibility and Environmental Management 29, 30.

67 Ibid

68 KPMG (n 31) and KPMG (n 28).

69 KPMG (31) 39.

70 Deloitte, *The Strategic Report: A Practical Guide to the New Regulations* (Deloitte 2013) <www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Services/Audit/uk-audit-the-strategic-report-a-practical-guide-v.pdf> 9.

71 For a comprehensive and detailed discussion on ESVP, see A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013).

72 The OFR requirement was amended on 21 March 2005 in Schedule 7ZA UK Companies Act 1985; see also Company Reform Bill ss 393–5.

(when necessary)'.[73] The directive is regarded as the response to the introduction of the programme of sustainable business development from the European Commission, with a recommendation on environmental disclosures that led to the inclusion of a fair review of the business in the accounts.[74]

After the enforcement of s 417 of the UK Companies Act 2006, the directors' report in the form of a business review became the central narrative reporting document in the corporate disclosure regime.[75] The government's intention was to use an enhanced directors' report, specifically the business review, to satisfy EU and investor requirements. The general idea is that the business review's requirements for directors 'will be less onerous on companies but still useful for investors and other stakeholders'.[76] The amendment places an obligation on the directors of public companies to include in their annual business review anything that might be a liability to the company's profits through danger to its reputation, such as contracts with stakeholders who could potentially expose the company to risk through social or environmental harm.[77] The purpose of the business review is 'to inform members of the company and help them assess how the directors have performed their duty under section 172'.[78] The obligations imposed on quoted companies are more onerous in comparison. Their business reviews must 'to the extent necessary for an understanding of the development, performance or position of the company's business' include 'the main trends and factors likely to affect the future development, performance and position of the company's business and information about environmental matters, the company's employees, [and] social and community issues'.[79] If discretion is involved, directors will need to put 'good faith' as the criterion for making business decisions to promote the success of the company, using their power to decide whether or not to disclose information.

However, it is also argued that, in order to make the business review achieve the aim associated with directors' duties to promote the success of the company, it is important to offer more guidance to directors to avoid a box-ticking approach, especially in terms of the provision of a definition for non-financial key performance indicators. Furthermore, it is debatable whether the review will constitute a genuine account of the stewardship of all relationships in which the company is involved. On the positive side, as the second limb of the ESVP embedded in s 172 of the UK Companies Act 2006, the requirement for a business review to be prepared and published, pursuant to the requirements in the Companies Act 2006, can do a good enough job if companies embrace the idea underpinning the need for it. It provides legislative support for minimum information disclosure in company law statutes on environmental and social issues. The requirement is regarded as one of the main approaches to the legal enforcement of CSR-related corporate strategy.[80]

73 Article 14 amending Article 46 of the Accounts Directive.

74 See European Commission, 'Towards Sustainability' (COM(92)(23)(5).

75 Aiyegbayo and Villers (n 45) 699.

76 A Reese, *Operating and Financial Review and the Business Review* (WSP Environmental December 2005).

77 D Arsalidou, 'The Withdrawal of the Operating and Financial Review in the Company Bill 2006: Progression or Regression?' (2007) 28 Company Lawyer 131, 134.

78 S 417(2) UK Companies Act 2006.

79 S 417(5) UK Companies Act 2006.

80 See V H Ho, 'Enlightened Shareholder Value: Corporate Governance beyond Shareholder–Stakeholder Divide' (2010) 36 Journal of Corporation Law 59; D K Millon, 'Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose without Law' in P Vasudev and S Watson (eds), *Corporate Governance after the Financial Crisis* (Edward Elgar 2012) 68.

The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 amended the UK Companies Act 2006 regarding the issue of information disclosure. Similar to OFR and business review, writers of strategic reports will need to consider which CSR elements are material to the successful performance of the company and which are in line with the directors' duty 'to promote the success of the company'. These regulations came into force on 1 October 2013 and will take effect for financial years ending on or after 30 September 2013. Companies with a calendar year end therefore needed to include modified corporate reports when they published their 2013 reports in spring 2014. Section 417 of the Companies Act 2006 was repealed in the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.[81] Instead of a 'business review', companies must now produce a 'strategic report' pursuant to the new sections 414A–D of the Companies Act 2006.

The nature and scope of the strategic report principally replicates the business review. However, there are also a few changes for quoted companies. Firstly, apart from environmental matters, company employees and social and community issues,[82] quoted companies will also have to include, 'to the extent necessary for an understanding of the development, performance or position of their business', information about human rights issues, including information on any human rights policy and its effectiveness.[83] Secondly, quoted companies will also have to include, with the purpose of enhancing the requirements on employees:

> a breakdown showing, at the end of the financial year, (i) the number of persons of each sex who were directors of the quoted company, (ii) the number of persons of each sex who were senior managers of the quoted company and the undertakings consolidated in the quoted company's accounts, and (iii) the number of persons of each sex who were employees of the quoted company and its consolidated undertakings.[84]

Thirdly, taking the environmental issues one step further, 'disclosure concerning greenhouse gas emissions' was introduced into part 7 of the directors' report, where a quoted company is required to 'state the annual quantity of emissions in tonnes of carbon dioxide'.[85] Another two terminologies were also introduced to consolidate the scope of strategic reports from quoted companies, namely 'company's strategy' and 'business model'.[86] These are terms that are repeatedly used in corporate governance codes when discussing annual reports,[87] long-term corporate value[88] and advice from audit committees.[89] Therefore, this new requirement can be regarded as a bridge between the UK Companies Act 2006 and the UK Corporate Governance Code, making existing 'comply or explain' disclosures mandatory. In the author's opinion, the new strategic report has not substantially changed the requirements embedded in the business review. However, it is positive to see more detailed requirements regarding employees and environmental issues, as well as a recognition of human right issues and links with corporate governance codes and information disclosure for quoted companies.

81 S 5 UK Companies Act 2006 (Strategic Report and Directors' Report) Regulation 2013.

82 S 417(5) UK Companies Act 2006.

83 S 414C(7)(b) UK Companies Act 2006 (Strategic Report and Directors' Report) Regulation 2013.

84 Ibid s 414C (8)(c).

85 Ibid s 15(2).

86 Ibid s 414C(8)(a)(b).

87 S C1.1. UK Corporate Governance Code 2012.

88 Ibid s C1.2.

89 Ibid s C3.4.

In China, mandatory information disclosure within the company law legislation will make the corporate objectives-related provision, Article 5 of CCL 2006, which requires companies to undertake social responsibility and observe business ethics, enforceable and effective.[90] Although there has been an increasing trend for disclosure through empirical research,[91] minimum requirements for listed companies within CCL will be helpful in promoting transparency through corporate information disclosure on social and environmental issues, in order to mitigate negative impacts, such as corporate scandals, and to promote and establish the centrally planned harmonious society. The legal requirements will also be of value to society more generally, either better to gauge the development of policy or to supplement the enforcement of policy by regulatory organisations.[92] Moreover, if CSR information disclosure is becoming an increasingly accepted corporate strategy in practice, legal requirements within CCL will make such common commitments unified and standardised. Finding the most appropriate regulatory framework that is efficient, enforceable and fits into the national legal system and economic development stage seems much more sensible than arguing about the nature of CSR if it is truly voluntary. It is argued by Buhmann that legislation on normative CSR may constitute pre-formal law.[93] The regulatory focuses on CSR, in a positive and progressive manner, will make corporations 'want to do what they should do'.[94] The legal recognition of CSR will create institutional constraints on directors' discretions when making decisions and facilitate corporate goals towards interests of a wide community of stakeholders for the social, environmental and, most importantly, long-term corporate interests.[95] Therefore, the mandatory requirement on CSR-related information disclosure can be regarded as a very effective initial step for establishing a systemic CSR legislative framework.

With the addition of supplementary enforcement measures, such as quantitative information requirements, corporate accounting standards and recruitment form reporting for annual reports, legislative experiences on the strategic report from the UK Companies Act 2006 are helpful for CCL legislation development. In detail, firstly, regarding the regulative objects, 'a quoted company' must include information about environmental matters, employees and social, community and human rights issues in its strategic report

90 See ss 172 and 414C UK Companies Act 2006; also in Sweden, Spain and Finland, state-owned companies are required to report on different aspects of their non-financial performance, e.g. Government Resolution of State Ownership Policy 2011 (Finland), Article 39 Spanish Sustainable Economy Law 2011, and Guidelines for External Reporting by State-owned Companies 2007; the German Reform Act on Accounting Regulations 2004 requires that companies examine and report on key financial and non-financial indicators that materially affect the development or performance of the company in their annual report; Article 225 French Grenelle II Act imposed a CSR-reporting and social and environmental information obligation for listed companies and other companies based on the number of employees and balance sheet total; furthermore, with the aim of motivating and inspiring Danish business to take an active position on CSR, the Danish Parliament (*Folkertinget*) passed a Bill in 2008 as an amendment to the Danish Financial Statement Act. As a result, approximately 1100 large businesses in Denmark are now legally required to include reports on three dimensions in their annual report, including CSR policies, how these policies are translated into actions and what the business has achieved as a result of working with CSR, and expectations for the future.

91 KPMG (n 31); see also C Marquis and C Qian, 'Corporate Social Responsibility Reporting in China: Symbol or Substance?' (2014) 25 Organization Science 127.

92 M J Rhodes, 'Information Asymmetry and Socially Responsible Investment' (2010) 95 Journal of Business Ethics 145, 148.

93 K Buhmann, 'Corporate Social Responsibility: What Role for Law? Some Aspects of Law and CSR' (2004) 4 Corporate Governance 188, 192.

94 P Selznick, *The Communitarian Persuasion* (Woodrow Wilson Centre Press 2002) 102.

95 C Nakajima, 'The Importance of Legally Embedding Corporate Social Responsibility' (2011) 32 Company Lawyer 257, 258

based on the Companies Act 2006.[96] Similarly, in the proposed section on CSR-related information disclosure in CCL, the regulatory objective should apply to listed companies in China. This requirement makes information disclosure possible and logical with the possible link with the corporate governance code, and the CSR of these listed companies will have a bigger impact on stakeholders. These listed companies are likely to have instant and broader influence on both society and community since they have multi-stakeholder groups, which in turn will have a further effect on CSR information disclosure. Moreover, the listed companies always play an active role in social activities, and are closely followed by the public and regulated by the government with associated high political costs and attention.[97] They are more likely to disclose information in detail in order to reduce political concerns and relieve political and supervisory pressure.[98] Therefore, companies listed on the stock exchange should be a regulatory target for mandatory CSR disclosure, while corporation size should prompt companies to decrease social pressure by disclosing to the public with positive effects.

The content of the report in CCL should be consistent with the requirements in UK law on the scope of the reporting to include environmental, social, community and human rights issues. Basic concerns surrounding these issues will help corporations to establish a reputable corporate image, win understanding and support from local communities and other stakeholders through communications, and enhance the credibility of their reports. This legal requirement would partly solve the problem of the lack of a unified mandatory social responsibility information disclosure format, replacing the current inadequate qualitative and quantitative information that results in questionable reliability and poor comparability of CSR information between companies.[99] The human rights element will support China's endorsement of the 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework', where business and human rights came together.[100] The Ruggie Guiding Principles are grounded in a recognition of the state's existing obligations to respect, protect and fulfil human rights and fundamental freedoms,[101] which have been regarded as the three pillars of the framework. The endorsement of the Ruggie Framework together with legislative experience of strategic reports will make the corporate responsibility to respect, protect and fulfil human rights desirable for this proposed legislative reform.

Furthermore, the term 'key performance indicators', defined as factors by reference to which the development, performance or position of the company's business can be measured effectively,[102] should also be introduced into CCL in order to make information disclosure effective, relating to environmental and employee matters, as non-financial

96 S 414C(7)(b) UK Companies Act 2006 (Strategic Report and Directors' Report) Regulation 2013.

97 R Watt and J Zimmerman, 'Towards a Positive Theory of the Determination of Accounting Standards' (1978) 53 Accounting Review 112, 115–16.

98 S S Cowen, L B Ferreri and L D Parker, 'The Impact of Corporate Characteristics on Social Responsibility Disclosure: A Typology and Frequency-based Analysis' (1987) 12 Accounting, Organizations and Society 111, 113–14.

99 Y Tang and D Chen, 'Analysis of Present Situation, Foundation and Content about Corporate Social Responsibility Information Disclosure in China' (2012) M&D Forum 96, 98.

100 J Ruggie, 'Business and Human Rights: Together at Last: A Conversation with John Ruggie' (2011) 35 Fletcher Forum of World Affairs 117; for more discussion on China and the international human rights system, see S Sceats and S Breslin, 'China and the International Human Rights System' (Royal Institute of International Affairs 2012).

101 Guiding Principles (a), 'Guiding Principles on Business and Human Rights: Implementation of the United Nations "Protect, Respect and Remedy" Framework'.

102 See s 414C(4) UK Companies Act 2006 (Strategic Report and Directors' Report) Regulation 2013.

information disclosure targets. Despite criticism on offering more guidelines related to these indicators in UK law, this minimum requirement should be regarded as the pre-condition for a more mature legislative treatment of information disclosure within CCL. This requirement fits within the triple-bottom-line framework, which includes environmental issues (energy, water, waste and legal compliance), social issues (recruitment, employees' rights, health and safety, training and education, non-discrimination, child labour, bribery and community investment) and financial issues.[103] Focusing on the last of these three factors, corporations will be able to achieve their operational targets and economic goals, which are regarded as the pre-conditions for disclosing their CSR information, because those corporations with poor performance are always unlikely to undertake CSR or engage in CSR information disclosure.[104] In order to promote CSR in a systematic manner, an evolving CSR reporting system should be established with different levels of performance indicators.[105] The transplant of legislative experience from the UK Companies Act 2006 will enable China to improve the breadth of disclosure to satisfy stakeholders' needs and simultaneously foster corporate values. The transplant will also help CCL to develop in line with international principles and other soft laws, such as corporate governance codes.

6 The unique mandatory CSR information disclosure system in China

Legislative experience on strategic reports from the UK Companies Act 2006 is transplantable for adopting a minimum standard at the national level to promote CSR and corporate transparency. However, path dependence theory attributes national differences in corporate law and corporate governance models to divergent historical and social underpinnings in different jurisdictions, and suggests that 'the lesson of history . . . is that while markets have always been there, they have always operated in the context of geography, religion, language, folk ways, families, armies, and government, never in a vacuum'.[106] Path dependence, a comparatively new theory originating in the 1980s, suggests that an outcome or decision is shaped in specific and systematic ways by the historical path leading to it, as well as by other factors within the socio-economic context.[107] While convergence theorists predict that countries, especially countries with weak legal systems, will adopt certain legal rules that have been demonstrably efficient in other jurisdictions, theorists who adhere to path dependence normally argue that divergence will still exist because legal rules are shaped by pre-existing political and social forces.[108] As part of the domestic legal and financial framework, a corporate law system has significant sources of path dependence, which include historical accidents as well as economic and political

103 International Finance Corporations and Shanghai Stock Exchange, *Sustainability Reporting Guidelines: Mapping and Gap Analyses for Shanghai Stock Exchange* (2011) <www1.ifc.org/wps/wcm/connect/19231a804886585bb596f76a6515bb18/SSE_IFCReport%2BEnglish.pdf?MOD=AJPERES&CACHEID=19231a804886585bb596f76a6515bb18> 3–4; see also T F Slaper, 'The Triple Bottom Line: What Is It and How Does It Work?' (2011) 86 Indiana Business Review 4.

104 J L Campbell, 'Why Would Corporations Behave in a Socially Responsible Way? An Institutional Theory of Corporate Social Responsibility' (2007) 32 Academy of Management Review 946.

105 J Wang, S Qin and Y Cui, 'Problems and Prospects of CSR System Development in China' (2010) 5 International Journal of Business Management 128, 133.

106 K Moore and D Lewis, *Foundations of Corporate Empire: Is History Repeating Itself* (Financial Times/Prentice Hall 2000) 219.

107 O A Hathaway, 'The Course and Pattern of Legal Change in a Common Law System' (2001) Iowa Law Review 101, 103–04.

108 K Pistor, 'Patterns of Legal Changes: Shareholder and Creditor Rights in Transition Economies' EBRD Working Paper 49 (2000).

particulars of the domestic system.[109] The persistence of these sources significantly contributes to the stability of the domestic corporate governance system in any local socio-economic environment.

Path dependence theory can be regarded as a theoretical base for the adoption of a mandatory information disclosure system with many unique characteristics shaping a particular nation's unique corporate governance model and transformation, corporate law development, enforcement process, shareholding structure, civil procedure law, stage of economic development, history, culture and traditions. It has been argued by Bebchuk and Roe that the initial ownership structure in a country will directly influence the subsequent development of its ownership structure and laws.[110] Furthermore, these authors developed the theory to suggest that the interested parties possessing the power to influence ownership structure and corporate law will have both the incentive and the power to impede changes that might improve efficiency but are contrary to their private control interests.[111]

The enforcement of law and regulatory systems for corporate information disclosure will be different in China than it is elsewhere, due to the unique and historical social relationships between controlling shareholders and local government, and the guanxi between controlling shareholders and company directors.[112] The uniqueness of the information disclosure system stems from the special relationship with the report's readers and the fact that China was the first Communist nation in the world to have a stock exchange, and since 1990 it has been the only socialist country to initiate the creation of a market-style modern enterprise system, achieved through a corporatisation and shareholding framework but without privatising its SOEs.[113] China needs a unique system of its own, shaped by the 'socialist market economy with Chinese characteristics'. By extension, this is also the case for a putative and unique Chinese CSR information disclosure system.

6.1 Developing regulations from multiple legislative sources

The Chinese Stock Regulatory Commission made CSR reporting a formal requirement for companies from the financial industry, companies listed on foreign exchanges and companies in the corporate governance composite index group on the Shanghai Stock Exchange and companies in the Shenzhen 100 composite stock index. However, no guidelines have been provided by the Chinese Stock Regulatory Commission on any details of the information that should be disclosed and directors have some discretion on information that should be reported. However, the impact of this legislation is limited by the legislative objective and lack of guidelines for enforcement.

According to the Constitution of the People's Republic of China 1982 and the Law on Legislation of the People's Republic of China 2000, statutory laws can be classified into two tiers at the national level and the local provincial level according to the hierarchy of their authority.[114] Legislation may take the form of laws, regulations, rules, measures, decisions or resolutions, although law is the most commonly used type. Below the Constitution and

109 L Bebchuk and M J Roe, 'A Theory of Path Dependence in Corporate Governance and Ownership' (2000) 52 Stanford Law Review 127.

110 Ibid.

111 Ibid 132.

112 J Zhao and S Wen, 'Gift Giving, Guanxi and Confucianism in a Harmonious Society: What Chinese Law could Learn from English Law on Aspects of Directors' Duties' (2013) 34 Company Lawyer 381.

113 See C Yao, *Stock Market and Futures in the People's Republic of China* (OUP 1998).

114 See Article 95 Constitution of the People's Republic of China 1982 and Article 2 Legislation of the People's Republic of China 2000.

law are administrative regulations made and amended by the State Council. These legislative approaches all fit into the CSR information disclosure system, as a key part of corporate strategy for Chinese companies through gaining trust and credibility from the government and the public. It is believed that mandatory CSR information disclosure will assess the congruence between the social value implied by corporate activities and social norms.[115] However, it is necessary to integrate an efficient and comprehensive CSR information system with a minimum standard from corporate law via the government legislative framework level and supplemented by regulations from stock exchange, province and city level. Therefore, a unique and hybrid CSR information disclosure regulatory framework, incorporating legislative elements from company law (as suggested in this article and informed by the legislative experience from the strategic report from the UK Companies Act 2006), as well as other regulatory instruments from the stock exchange, government authorities and agencies in other forms, will work for China to fit its unique corporate governance model. This hybrid CSR information disclosure framework should be directed by mandatory rules in CCL and supplemented by government legislation, regulations and guidelines from government authorities, agencies at different levels and stock exchanges.

Apart from guidelines at the provincial level, other government legislation should also put CSR information disclosure on the agenda to enhance a more efficient hybrid framework. For example, a problem that was revealed by the *Study of Corporate Social Responsibility Reports in China 2012–2013* by SynTao is the low percentage of independent auditing of CSR reports (only 3 per cent).[116] Critics argue that CSR reports without independent third-party inspection and supervision are no more than company brochures.[117] Therefore, in order to enhance the effectiveness of mandatory CSR report proposals within CCL, it might be worth arguing the case for adopting a mandatory independent auditing process for CSR reporting in Chinese auditing law or in the Regulations for the Implementation of the Audit Law of the People's Republic of China. Independent auditing will work with intense monitoring from stakeholders and verification from public sources such as the Environmental Protection Bureau and the media.

As far as the detailed requirements and guidelines for drafting and implementation of CSR reports are concerned, 'G4 Sustainability Guidelines: Reporting Principles and Standard Disclosure' and 'G4 Sustainability Guidelines: Implementation Manual',[118] both published by Global Reporting Initiative, are worth referencing to produce reports that meet international standards. The guidelines offer 'Reporting Principles, Standard Disclosures and an Implementation Manual for the preparation of sustainability reports by organizations, regardless of their size, sector or location'.[119] 'The Guidelines also offer an international reference for all those interested in the disclosure of governance approach and of the environmental, social and economic performance and impacts of organizations.'[120] Therefore, the guidelines will be applicable to listed companies in China in the preparation of their CSR reports on social, environmental and economic issues. Furthermore, the guidelines were drafted through a global multi-stakeholder process with the involvement of

115 J Wang, L Song and S Yao, 'The Determinants of Corporate Social Responsibility Disclosure: Evidence from China' (2013) 29 Journal of Applied Business Research 1, 1.

116 SynTao (n 29) 7.

117 Q Pang, 'Study: China's CSR Reports Need Improvement' *Global Times* (25 November 2010); available via <www.globaltimes.cn/content/596632.shtml>; see also D Kershaw, 'Waiting for Enron: The Unstable Equilibrium of Auditor Independence Regulation' (2006) 33 Journal of Law and Society 388.

118 Global Reporting Initiative, *G4 Sustainability Guidelines: Reporting Principles and Standard Disclosure/Implementation Manual* (2013) < www.globalreporting.org>.

119 Ibid 5.

120 Ibid.

representatives from various stakeholders and gatekeepers, including auditors. These internally recognised guidelines are also consistent with the logic of mandatory CSR reporting in CCL, as discussed in section 3.

6.2 Applying a two-way communication CSR reporting system in China

There is a range of methods to evaluate when seeking possible legislative protection for stakeholder groups, with relevant factors such as the introduction of provisions that mandate (or at least give legitimacy to) the relevant behaviour with specific enforcement measures. Despite the fact that companies are increasingly disclosing CSR information, it is questionable whether the current annual, standalone CSR reports on social and environmental factors can satisfy the increasing demand for corporate accountability.[121] The reporting system is still underdeveloped, and it is necessary to further enhance sustainability reporting and CSR reports by adopting a more systematic and standardised format in comparison with traditional economic reporting.[122] Mandatory or voluntary reports on social and environmental issues are not normally exclusive options in current practice; in fact they are highly complementary. Disclosure practice by companies may be driven by the need to legitimise their corporate activities. It is for the government to decide the most appropriate approach for reporting, with different levels of minimum mandatory requirements based on different criteria, including business nature and the size or type of the corporation.[123]

It is argued that CSR-related communications between corporations and their stakeholders were carried out in the form of annual CSR reports, or via the presence of CSR information in financial reports.[124] These reports transfer CSR-related information from the company to stakeholders, and are only issued and disclosed after the achievement of the CSR-related activities.[125] The process of transferring the information is via a one-way communication route, which is predictable, insufficient and not always transparent enough regarding comments and timeliness to give stakeholders a good understanding of the corporation's CSR decisions and actions. It is suggested that two-way communication, via a system under which information can be transferred between the company and its stakeholders in a bidirectional manner, should be established to make the CSR information disclosure system more efficient.[126] Under such a scheme, the 'informing' direction transmits CSR-related messages to stakeholders via reports and other media in order to involve them in the sustainable development of the company. This involvement will enable them to provide voluntary sustainable support for socially responsible corporate behaviours. On the other hand, the 'listening' direction will help the company to adapt to the needs of stakeholders by listening to their voices through questionnaires, surveys,

121 See C A Adams, 'The Ethical, Social and Environmental Reporting–Performance Portrayal Gap' (2004) 17 Accounting, Auditing and Accountability Journal 731; M J Milne and R Gray, 'Future Prospectus for Corporate Sustainability Report' in J Unerman, J Bebbington and B O'Dwyer (eds), *Sustainability Accounting and Accountability* (Routledge 2007) 184.

122 A R Belal and V Lubinin, 'Corporate Social Disclosure (CSD) in Russia' in S O Idowu and W L Filho (eds), *Global Practice of Corporate Social Responsibility* (Springer Verlag 2008).

123 KPMG, Unit for Corporate Governance in Africa, Global Reporting Initiative and United Nation Environment Programme, *Carrots and Sticks: Promoting Transparency and Sustainability – An Update on Trends in Voluntary and Mandatory Approaches to Sustainability Reporting* (KPMG 2010) 8.

124 M Liu, 'Corporate Social Responsible Actions and Consumer Respondents' (2006) 25 China Industry Economy 64.

125 H Chen and H Zhang, 'Two-way Communication Strategy on CSR Information in China' (2009) 5 Social Responsibility Journal 440, 441.

126 Ibid 442.

consulting sessions and collective opinion pools. The company can then make changes to upgrade the sustainable support for its CSR activities, and these adjustments can be disseminated through reports on more efficient CSR-related developments and strategies. The importance of informing stakeholders about CSR-related information should be given an equal weight to communication with and support from stakeholders, in order to make the information more attractive, useful and dynamic. A two-way communication system will promote good relations between various stakeholders and corporations through 'identification', which makes stakeholders feel they are being integrated, acknowledging their individualised value and ultimately promoting the company.[127]

In the case of Chinese companies, it has been found that most CSR reports lack sufficient communication with various stakeholders of the company in order to adequately reflect their expectations.[128] Zheng Wei, the senior project manager of CSR Asia, suggests that CSR reports should be linked closely to the interests of stakeholders. It is argued that 'for the case of Chinese listed companies, the earlier you learn your stakeholders' expectations, the more attractive and effective your CSR report is'.[129] A positive and appropriate dialogue with stakeholders is key to justifying the reasonableness and competitiveness of CSR reports, accommodating the needs of the reader and keeping them interested. This positive reaction from internal and external environments to corporations' CSR communication strategies will ensure a positive strategic management policy, boosting CSR within corporations and enforcing enlightened corporate objectives by mapping stakeholder relationships and stakeholder coalitions, assessing the nature of each stakeholder's interests and power, constructing a matrix of stakeholders' priorities, creating a matrix of corporate responsibility towards stakeholders, and making the corporate objectives in CCL 2006 more enforceable.[130] In this sense, a two-way disclosure system will propose a solid set of coherent principles and enforcement measures and processes, enhancing the integration of CSR initiatives as a key element of corporate culture and corporate value. Such a two-way strategy will help corporations to decide what to disclose and will encourage them to keep updating their information to make their CSR strategy fit their stakeholders' needs. To accommodate CSR projects that need a relatively long period of time for their implementation, a systematic two-way disclosure regime is key for the company in obtaining and disseminating updated social and environmental information.[131] Therefore, the guidelines and regulatory principles from different levels in the combined regulatory framework should highlight the importance of stakeholder dialogue to promote a two-way communication system within the CSR reporting system.

6.3 Forms through which CSR information can be disclosed in China

It is a practical issue to clarify the forms of CSR information disclosure that may be further required in other regulatory instruments from government agencies or authorities in order to enforce the mandatory requirement for strategic reports as stipulated within the UK Companies Act 2006. Regarding forms of CSR-related information disclosure, a few types

127 S Brammer and S Parvelin, 'Building a Good Reputation' (2004) 19 European Management Journal 704.

128 Z Li, 'Road to Transparency: The Current Situation, Tendency and Challenges of CSR Reports in China' in Social Resources Institute, *Road to Transparency: The Current Situation, Tendency and Challenges of CSR Reports in China* <www.srichina.org> 4.

129 W Zheng, 'Stakeholder Dialogue and Corporate Social Responsibility Communication' in Social Resources Institute (n 128) 6, 7–8.

130 J Zhao, 'Modernising Corporate Objective Debate towards a Hybrid Model' (2011) 62 Northern Ireland Legal Quarterly 361, 386.

131 H Chen, 'A Questionnaire Investigation on SRC in China' in *Proceedings of the 2nd Euro-Asia Conference on Environment and CSR 12–13 October 2007*, Bangkok, 56–60.

of document have been examined, including annual reports, individualised reports, and non-report vehicles such as advertisements and company brochures.[132] Of these public domain sources, there seems to be a consensus that annual reports are the most important and appropriate,[133] being treated both as a stewardship tool[134] and as an investment tool.[135] CSR-related information has been disclosed in China through four means including scattered information disclosure through annual reports, individualised information disclosure through annual reports, individualised information disclosure separated from annual reports, and information disclosure through the public media and press releases.[136] For scattered information disclosure, the information sources may be various documents such as corporate governance reports, business ethical reports, financial statements or their appendices, or directors' meeting reports where there is not a separate information disclosure report. However, there is a trend towards separate CSR reports with 99.1 per cent of companies choosing this option in a study from 2010.[137]

A scattered CSR information disclosure system always makes it troublesome and time-consuming for investors and other stakeholders to find useful and necessary information. On the other hand, individualised CSR reports make the information clear, understandable, systematic and locatable. It is sensible for corporations to keep their reports reader-friendly and visually pleasing in order to attract investors, especially potential minority shareholders, and in order to build better stakeholder communication. It is important to avoid overly complicated social income statements, value-added sheets or balance sheets, but to make the information effectively and efficiently disclosed to various shareholders and stakeholders. Considering that listed companies are currently required to issue annual reports in any of the three, or even all of these three, designated national newspapers (*China Securities Journal, Securities Times* and *Shanghai Securities Gazette Listed Firms*), it might be beneficial and easier to make it mandatory for listed companies to disclose information on social, environmental and human rights issues within their annual reports. However, with the development of CSR, corporate governance and corporate law in China and collective efforts from corporate insiders and gatekeepers, a 'comprehensive report' framework, which includes three types of information for each disclosure CSR item (including the corporate vision and

132 D Campbell and A C Beck, 'Answering Allegations: The Use of the Corporate Website for Restorative Ethical and Social Disclosure' (2004) 13 Business Ethics: A European Review 100; see also D Zeghal and S A Ahmed, 'Comparison of Social Responsibility Information Disclosure Media Used by Canadian Firms' (1990) 3 Accounting, Auditing and Accountability Journal 38.

133 T A Lee and D P Tweedie, 'Accounting Information: An Investigation of Private Shareholder Usage' (1975) Accounting and Business Research 280; see also T A Lee and D P Tweedie, 'Accounting Information: An Investigation of Private Shareholder Understanding' (1975) Accounting and Business Research 280; E Mirfazali, 'Corporate Social Responsibility Information Disclosure by Annual Reports of Public Companies Listed at Indonesia Stock Exchange' (2008) 1 International Journal of Islamic and Middle Eastern Finance and Management 275; Szabo (n 15); S Arvidsson, 'Disclosure of Non-financial Information in the Annual Report' (2011) 12 Journal of Intellectual Capital 277; A Amran, S P Lee and S Selvaraj, 'The Influence of Governance Structure and Strategic Corporate Social Responsibility Toward Sustainability Reporting Quality' (2013) Business Strategy and the Environment <www.researchgate.net/publication/261565149_Amran_A._Lee_S._P._and_S.Susela_Devi_%282013%29_The_Influence_of_Governance_Structure_and_Strategic_Corporate_Social_Responsibility_Toward_Sustainability_Reporting_Quality._Bus._Strat._Env>.

134 *Caparo Industries plc v Dickman* [1990] 2 AC 605 HL, per Lord Oliver of Aylmerton, 630–1.

135 PricewaterhouseCooper, *Corporate Reporting: A Time for Reflection: A Survey of the Fortune Global 500 Companies' Narrative Reporting* (PricewaterhouseCooper 2007) 6; see also Aiyegbayo and Villiers (n 45) 700.

136 Y Li and Y Liu, *Bluebook of Corporate Social Responsibility in China 2011* (People's Publishing House 2011) 346.

137 Chinese Academy of Social Science, *General Overview of CSR Reports in China* (2010); see also Z Li, *Research on Corporate Social Responsibility Information Disclosure (Qiye Shehui Zeren Xinxi Pilu Yanjiu)* (Economic Science Press 2008) 143.

goals, management approaches and performance indicators),[138] seems workable in China. This is a framework that allows two important aspects of accountability, namely completeness and comprehensiveness, to be easily, directly and simultaneously assessed.[139]

The content of this comprehensive reporting system should be consistent with the one required by the strategic report, including environmental, employee, social, community and human rights issues. This also fits in with the empirical research carried out by Wang, Song and Yao on all A-share companies listed on the Shanghai Stock Exchange on the contents of their CSR reports including: environmental issues (such as pollution control, environmental conservation, natural resource conservation and energy-saving/emission reduction) and social issues (such as production quality and safety, customer services, consumer rights, philanthropic giving, public welfare undertaking and community involvement). The scope of the employee information may be interpreted broadly and refer to issues such as 'health and safety, human rights, schooling, education and career perspectives'.[140] The content should be expanded to include human rights issues, especially after China's endorsement of the 'UN Guidelines on Business and Human Rights', in which business and human rights finally came together.[141] In the 'General Principles' section the Ruggie Guiding Principles are grounded in a recognition of the state's existing obligations to respect, protect and fulfil human rights and fundamental freedoms,[142] which have been regarded as the three pillars of the Ruggie Framework. The endorsement of the Ruggie Framework by the United Nations Human Rights Council on 16 June 2011, after years of struggle to develop corporate standards, made the corporate world's responsibility for human rights clear and is the foundation for this policy framework. The inclusion of human rights issues within the mandatory information disclosure requirement within the CCL is a golden opportunity for China and Chinese companies to promote their corporate image and human rights record.

6.4 Government interference and information disclosure

In the liberal political economy proposed by Adam Smith in his milestone work *Wealth of Nations*,[143] the government monitors and enforces the regulatory environment in which companies compete for profit, but should not directly be involved in a company's decisions and transactions. Since that time, many reasons have been advanced arguing that state control over commercial transactions will lead to the failure of the business organisation. It is argued that, based on the efficiency of the corporate form, direct involvement of state officials will impose on companies multiple political interests which will dilute project-making motives when social objectives collide with shareholders' wealth maximisation. It is also argued that informational asymmetry and uncertainty will constrain the effectiveness of coordination and interference from government. The willingness of governments in sharing the risk might weaken motives of companies in making more profit and lead to soft budget constraints with negative effects on a firm's efficiency. However, the effectiveness and necessity of government interference in business organisations have been questioned

138 L Bouten, P Everaet, L V Liedekerke, L D Moor and J Christiaens, 'Corporate Social Responsibility Reporting: A Comprehensive Picture' (2011) 35 Accounting Forum 187.

139 Ibid 202.

140 T Lambooy and N van Vliey, 'Transparency on Corporate Social Responsibility in Annual Reports' (2008) 5 European Company Law 127, 128.

141 Ruggie (n 100); for more discussions on China and the international human rights system, see Sceats and Breslin (n 100).

142 Guiding Principles (a) (n 101).

143 A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, E Cannan (ed) (University of Chicago Press 1776).

and discussed in various dimensions, especially after the financial crisis of 2008. Instead of having a direct role in facilitating and shaping dynamic growth, the state's ability to create and maintain a supportive growth climate is key for emerging markets to achieve economic miracles.[144]

In countries with emerging markets such as China, the incentives for and the quality of government officials and regulators are key determinants of corporate behaviour.[145] Groups who have controlling powers over corporate resources always have political power and can affect the level of investor protection, mostly in an unfair manner. For example, controlling shareholders prefer legislation and rules that will put minority shareholders in a disadvantaged position. In the case of China, half of the listed companies are controlled by SOEs which account for more than half of output and employment. This reaffirms a major concern of corporate governance in listed companies in emerging economies, namely controlling-shareholder expropriation or principal–principal, where controlling shareholders pursue their self-interests at the expense of corporate performance and the interests of minority shareholders.[146] SOEs play an important role in the Chinese economy to achieve the dual goals of shareholder profit maximisation and promotion of national interests.

As with the transformation of corporate governance and SOEs, so the development of CSR in China has to be achieved by informing the public and raising awareness of CSR-related issues.[147] CSR activities in China always include more involvement from government than similar initiatives in Western countries, where CSR strategies are driven by private sectors or non-governmental organisations.[148] In China, the government plays a triple role in the enforcement of the law, promoting CSR as a regulator, a supervisor and a promoter.[149] The 'Guidelines to the State-Owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities' were effectively introduced by SASAC to promote socially responsible SOEs. The State Council publicly demonstrated its support for CSR by enacting and disseminating the 2008 SASAC Guideline. The introduction of this guideline is a strong indication that CSR has been centrally and politically authorised and accepted by the Chinese government and companies should implement their CSR policies to satisfy the trend. It is suggested that SOEs should establish a CSR information-releasing system, 'providing updates and regulator information about CSR performance and sustainable development, plans and measures in carrying out CSR'.[150] This advice for SOEs can be regarded as an initial attempt at building a CSR information-releasing system: a unique system that can be developed to enable all listed companies to adopt policies to make CSR measureable and embedded within corporate strategic management policy. This guideline does not provide explicit or detailed

144 G Bertucci and A Alberti, 'Globalization and the Role of the State: Challenges and Perspectives' paper presented at United Nations World Public Sector Report 2001 on 'Globalization and the State'.

145 M Ararat and G Dallas, 'Corporate Governance in Emerging Markets: Why it Matters to Investors – and What They Can Do about It' (2011) Private Sector Opinion 1, 6.

146 Y Su, D Xu and P H Phan, 'Principal–principal conflict in the Governance of the Chinese Public Corporation' (2007) 4 Management and Organization Review 17; see also M N Young, M W Peng, G D Bruton and D Jiang, 'Corporate Governance in Emerging Economies: A Review of the Principal–Principal Perspective' (2008) Journal of Management Studies 196.

147 Knowledge Wharton, 'Corporate Social Responsibility in China: One Great Leap Forward, Many More Still Ahead' (University of Pennsylvania 2009).

148 L W Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' (2010) 28 Berkeley Journal of International Law 64, 91.

149 J Zhao, 'The Harmonious Society, Corporate Social Responsibility and Legal Responses to Ethical Norms in Chinese Company Law' (2012) 12 Journal of Corporate Law Studies 163, 199.

150 See State-owned Assets Supervision and Administration Commission, 'Guidelines to the State-Owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities', s 18.

instructions on how to establish this information system. However, the adoption of strategic reporting from the UK Companies Act 2006 in the next CCL will be a very good start for this system. In this way, government interference will enable strategic reporting requirements to be enforced more effectively with the support of the SASAC guideline.

7 Conclusion

It is almost impossible to maximise companies' value and financial performance if they are not socially responsible and if they do not share their CSR information with the public.[151] Furthermore, there is no point in companies investing in CSR activities without disclosing information of such activities in order to maximise their reputation.[152] CSR-related information disclosure in annual reports will address public and legislative concerns and project an image of companies' social awareness.[153] It is the KPMG view that the debate on whether corporations should publish a corporate responsibility report is over and listed companies that still do not do this 'should ask themselves whether it benefits them to continue swimming against the tide or whether it puts them at risk'.[154] The question now that listed companies should ask themselves should be about the quality and content of their corporate responsibility reporting and the most efficient way to reach and communicate with the most relevant audience to achieve multiple stakeholder engagements. The author agrees with Professor Freeman's opinion on the future of CSR and the worthy goal of superseding CSR with a consideration that the roles of responsibility, sustainability and ethics are at least as important as the completion of projects.[155]

It is argued in this article that mandatory rules will help to produce narrative disclosures of a higher quality, which will lead to an increase in the amount of disclosure and reduce variability by an absolute amount attributable to the size of the company. The mandatory standards and rules, as well as voluntary guidelines, are key to achieving uniformity in CSR reporting, being reactive to environmental and social factors. This legitimate action could be regarded as evidence of an assessment of the company's corporate citizenship and as responses to social contracts, where corporations agree to perform various socially desirable actions in return for approval of their corporate citizenship as a reward for their ultimate survival. The legitimacy of their actions via disclosure will make corporations justify their continued existence.

It is clear that the system under which China could practise CSR information disclosure is a unique one within a unique corporate governance model and at a distinct stage of economic development with a shareholding structure and stakeholder groups like no

151 M L Pava and J Krausz, 'The Association between Corporate Social Responsibility and Financial Performance: The Paradox of Social Cost' (1996) 15 Journal of Business Ethics 321.

152 J Hasseldine, A I Salama and J S Toms, 'Quantity Versus Quality: The Impact of Environmental Disclosures on the Reputations of UK plcs' (2005) 37 British Accounting Review 231.

153 D M Patten, 'Intra-industry Environmental Disclosures in Response to the Alaskan Oil Spill: A Note on Legitimacy Theory' (1992) 17 Accounting, Organization and Society 471.

154 KPMG (n 31) 10.

155 Speech of Professor Edward Freeman at the Fifth International Conference on Corporate Social Responsibility: The Future of CSR, October 2012; based on the note of the author; see also E Freeman and A Moutchnik, *Stakeholder Management and CSR: Questions and Answers* (2013) Umwelt Wirtschafts Forum <http://link.springer.com/article/10.1007%2Fs00550-013-0266-3#>.

others.[156] With the development of the Chinese economy, company law and corporate governance, the CSR information disclosure will not stay the same. However, the strategic reporting legislative experience from the UK seems appropriate and transplantable to promote CSR in China through corporate law legitimation. Similar to other transplantable legislative experiences from Western corporate law, for example, stock market rules and a corporate governance code, the local meaning and enforcement of these transplantations is inevitably different due to the dominance of the state in listed companies, as both shareholder and regulator.[157] In the light of rapid Chinese economic development, social problems caused by profit-driven corporate decisions are hindering sustainability in China. Radical restructuring and privatisation in an atmosphere of irresponsible corporate behaviour has brought severe social instability and a wide range of stakeholder reactions.[158] The enforcement of the law related to CSR in promoting stakeholders' interests depends heavily on political interference, public awareness, business disclosure of social and environmental issues, and the improvement and support of a sound legal system in China. The transplanted mandatory strategic reporting requirement in the next CCL, combined with additional regulatory documents and guidelines from local government, stock exchanges and government agencies, seems to comprise an efficient way to maintain a good balance and persuade companies to disclose their non-financial information. Furthermore, it is more efficient for CSR-related information to be mandated within the already existing framework of financial and non-financial information disclosure to fit into the philosophy of the business case of CSR.[159] The rationales supporting the business community should engage and pursue CSR policies, activities and practices from a primarily corporate economic/financial perspective rewarded by the market, but also make CSR disclosure within the existing framework convincing and effective.[160] The business case of CSR allows companies to benefit from CSR opportunities and enables them to enhance their competitiveness by multi-stakeholder engagement and communication, while mandatory CSR information disclosure within financial reports can be regarded as an effective means of acknowledging the interrelated nature of CSR and the financial performance of companies.[161]

Despite the positive trend towards increasing and better quality CSR reporting from Chinese companies, with associated progress towards a more comprehensive and competitive reporting system, this article recommends the adoption of the comprehensive report framework to facilitate the completeness and comprehensiveness of reports and improve corporate accountability towards the readers of the reports as well as shareholders who are potentially willing to invest. This promotion of comprehensive reporting is subject to the active participation of gatekeepers, such as accountants and auditors, to ensure the

156 For the unique corporate governance model in China, see O K Tam, 'Ethical Issues in the Evolution of Corporate Governance in China' (2002) Journal of Business Ethics 303; J Zhao and S Wen, 'Promoting Stakeholders' Interests in the Unique Chinese Corporate Governance Model: More Socially Responsible Corporations?' (2010) International Company and Commercial Law Review 373, 377–8; M Yan, 'Obstacles in China's Corporate Governance' (2011) Company Lawyer 311.

157 R Tomasic, 'Corporate Governance in Chinese-listed Companies Going Global' (2014) 2 Chinese Journal of Comparative Law 155, 155.

158 L Zu, *Corporate Social Responsibility, Corporate Restructuring and Firm's Performance* (Springer-Verlag 2009) 301.

159 See M Weber, 'The Business Case for Corporate Social Responsibility: A Company-Level' (2008) 26 European Management Journal 247.

160 A B Carroll and K M Shabana, 'The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice' (2010) International Journal of Management Review 85.

161 M L Barnett, 'Stakeholder Influence Capacity and the Variability of Financial Returns to Corporate Social Responsibility' (2007) 32 Academy of Management Review 794, 795.

reports are comprehensible, competitive, complete and independent. Government plays a particularly important role in CSR reporting, not only for SOEs, which are directly controlled by central government, but also for their suppliers and customers. It is clear that inefficiency in the enforcement of CSR-related laws is a collective problem, with causes ranging from a poor information disclosure system, a record of disrespect for human rights and unregulated political power, to a high degree of political interference in the law, corporate governance and CSR.[162]

162 For more discussions on political interference and CSR, see P A Gourevitch and J Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton University Press 2007) chs 4 and 6; W Li and R Zhang, 'Corporate Social Responsibility, Ownership Structure, and Political Interference: Evidence from China' (2010) 96 Journal of Business Ethics 631; Y L Cheung, W Tan and Z Zhang, 'Does Corporate Social Responsibility Matter in Asian Emerging Markets' (2010) 92 Journal of Business Ethics 401; H Li, L Meng, Q Wang and L Zhou, 'Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms' (2008) 87 Journal of Development Economics 283.

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Bridging the gap between alternative dispute resolution and robust adverse costs orders

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Introduction

One of the defining features of the Woolf reforms was its attempt to shift the focus in civil litigation away from the traditional adversarial culture of resolving disputes to one which was centred on a philosophy of party cooperation and, more significantly, on settlement. As Lord Woolf made clear in his 1996 Final Report, 'the philosophy of litigation should be primarily to encourage early settlement of disputes'.[1] This philosophy transformed the orthodox understanding of the civil litigation process from one that did not require the parties, in any formal sense, to engage in settlement negotiations, to one that embraced settlement as a fundamental and necessary aspect of the civil justice system.

To facilitate settlement, Lord Woolf gave alternative dispute resolution (ADR) an enhanced role within the framework of the Civil Procedure Rules (CPR). The CPR impose a positive duty upon the court to encourage parties to engage in ADR processes as part of its case management powers, and thereby act as a means to further the overriding objective of dealing with cases justly and at proportionate cost.[2] The CPR also oblige parties to consider and engage in ADR processes both before and during the litigation process.[3] However, Lord Woolf went further than this in his efforts to realise a change in litigation culture. He ensured that the courts were equipped with appropriate powers to penalise parties which failed to consider ADR or unreasonably refused to engage with it.[4] These

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1 The Rt Hon Lord Woolf, *Access to Justice Interim Report* (Lord Chancellor's Department 1995) ch 2, para 7(a) (Interim Report) and the Rt Hon Lord Woolf, *Access to Justice Final Report* (Lord Chancellor's Department 1996) (Final Report).

2 CPR 1.4 (2)(e) provides that the case management duties of the court include: 'encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure'.

3 Before proceedings are issued the parties will be obliged to engage with the pre-action protocols. For a list of the current pre-action protocols see <www.justice.gov.uk/courts/procedure-rules/civil/rules> accessed 7 January 2015.

4 For a discussion of the various methods by which the courts may encourage ADR, see Shirley Shipman, 'Court Approaches to ADR in the Civil Justice System' (2006) 15 Civil Justice Quarterly 181.

powers include the making of adverse costs orders against a party which, although successful in their claim or defence, is found to have unreasonably refused to engage in ADR (the 'successful party'). The consequence of such an order being made against a successful party is that the usual costs order,[5] which requires the unsuccessful party to pay the costs of the successful party, is set aside. Where this occurs, the type of adverse costs order that the courts tend to make is one that restricts the successful party to or deprives it of recovering no more than some or all of its costs from the unsuccessful party. The author refers to these types of costs orders as 'cost deprivation orders' (CDOs).

However, despite the CPR conferring upon the courts the discretion to make a wide range of adverse costs orders, judges, most notably the senior judiciary, have been reluctant to fully utilise those powers. The courts appear to be more comfortable in making CDOs rather than making orders that oblige the successful party to *reimburse* some of the unsuccessful party's costs which that party has incurred because of the failure of the successful party to engage in ADR. The author refers to these types of costs orders as 'paying orders' (POs) because they oblige the successful party to actually make a financial contribution towards the costs of the unsuccessful party.

This article investigates and seeks to shed light upon an area which has not received attention in the current literature: the discrepancy which exists between judicial endorsement of ADR and the failure of the courts to translate or reflect that endorsement through making robust costs orders in the form of POs. It will be argued that this discrepancy has occurred as a consequence of the orthodox yet contradictory understanding among the senior judiciary that ADR, in particular mediation, is not mandatory within the English civil justice system. In this regard the author will seek to provide an alternative perspective of the Court of Appeal's decision in *Halsey v Milton Keynes General NHS Trust*[6] by considering the effect it has had on the specific issue of the types of adverse costs orders which the courts make and the impact the decision has had upon subsequent judicial reluctance in making POs.

It will be argued that the courts should be more willing to make POs to fulfil two policy objectives. The first is to achieve fairness by reimbursing the unsuccessful party for costs it has had to incur which could have been avoided but for the successful party's failure to engage in ADR[7] or, at the very least, for failing to engage in ADR which would have had the benefit of narrowing the issues between the parties and allowed the parties to gain a better understanding of the strengths and weaknesses of their arguments in the event that the parties have to revert to the court process. The second objective is to reinforce the policy of requiring parties to seriously consider ADR and, as envisaged by Lord Woolf, preserve the court process as a last resort.[8]

Part 1 of the article will consider Lord Woolf's ADR philosophy within the civil justice system. It will also reflect on the views of the two opposing ADR schools of thought as well as adopting a comparative approach by considering the Scottish approach towards ADR following Lord Gill's reforms to the Scottish civil courts.[9] Part 2 will explain and analyse the main costs provisions under the CPR and will focus upon the court's powers to

5 CPR 44.2(2)(a).

6 [2004] 1 WLR 3002.

7 *Leicester Circuits Ltd v Coates Brothers plc* [2003] EWCA Civ 333; 2003 WL 1610252. Also see the comments of Lord Justice Jackson, Review of Civil Litigation Costs Final Report (14 January 2010) (Final Report) ch 36, 355–6.

8 Interim Report (n 1) s 1, para 9(a).

9 Report of the Scottish Civil Courts Review <www.scotcourts.gov.uk/about-the-scottish-court-service/the-scottish-civil-courts-reform> accessed 7 January 2015.

make adverse costs orders in circumstances where the successful party has unreasonably refused to engage in ADR. Part 3 will critically analyse English ADR jurisprudence and Part 4 will advance two alternative approaches to the making of robust adverse costs orders in cirumstances where the successful party has unreasonably refused to engage in ADR.

1 The Woolfian ADR philosophy and diverging ADR opinions

The role of ADR within the civil justice system was greatly enhanced as a consequence of the Woolf reforms. One of the principal aims of Lord Woolf's review of the civil justice system was to improve access to justice and reduce the costs of litigation.[10] One of the main causes of these problems was, Lord Woolf observed, the traditional adversarial system of party control and minimum judicial intervention which caused or at the very least permitted the development of excessive delay in the resolution of disputes, increased costs for the parties and drained the courts' finite resources.[11] Although some, like Sir Jack Jacob, the doyen of English civil procedure, favoured the adversarial system as enhancing the standing, influence and authority of the judiciary at all levels,[12] Lord Woolf wanted to give effect to an idea that in pre-trial matters the court *should* take charge and manage disputes through the litigation process in order to ensure that litigation is conducted with reasonable speed and is pursed through mechanisms other than the court process.[13] To address these ailments of the civil process, Lord Woolf sought to eliminate an adversarial approach to the conduct of litigation which allowed parties to freely engage in tactical skirmishing which increased costs and delay and undermined the court's ability to secure substantive justice (or justice on the merits). Further, Lord Woolf wanted the court to promote settlement by exercising its case management powers and thereby reduce costs and delay for the parties, even though that would not lead to a trial or produce a judgment.[14] Thus, Lord Woolf believed that a trial must be avoided wherever possible and must be a last resort and one that would only be necessary if other settlement options had failed.[15]

More recently, Briggs LJ in his recent *Chancery Modernisation Review*[16] has gone further in advocating the need for the Chancery courts to move away from the perception that the function of case management is almost entirely to be concerned with the preparation and management of pending proceedings to trial. Rather, courts should manage disputes in the widest possible sense in which 'a trial is statistically unlikely to be its conclusion'.[17] In doing so, the courts should, Briggs LJ has recommended, take a more active role in the encouragement, facilitation and management of dispute resolution in the widest sense, including ADR as part of that process, rather than merely focusing on case preparation for trial.

The central premise upon which civil justice rests is the overriding objective of dealing with cases justly and at proportionate cost.[18] The court is required to further the overriding

10 Woolf, Interim and Final Reports (n 1).

11 Woolf, Interim Report (n 1) ch 4(1).

12 Sir Jack I H Jacob QC, *The Hamlyn Lectures: The Fabric of English Civil Justice* (Stevens 1987) 12.

13 Woolf, Final Report (n 1). See also Lord Woolf's comments in ch 19 of Christopher Campbell-Holt, *Lord Woolf: The Pursuit of Justice* (OUP 2008).

14 CPR 1.4 sets out the court's duty to manage cases. CPR 1.4(2)(e) provides that active care management includes 'encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure'.

15 Final Report (n 1) para 9(a).

16 Lord Justice Briggs, *Chancery Modernisation Review: Final Report* (December 2013).

17 Ibid 67–8.

18 CPR 1.

objective[19] by actively managing cases, which includes encouraging parties to use an ADR procedure if appropriate.[20] There are also various obligations on the parties to consider ADR and settlement not only during the litigation process[21] but also at the pre-action stage of litigation, i.e. before formal proceedings are issued. Before proceedings can be issued, parties are required to engage with relevant pre-action protocols, each of which require the parties to cooperate with each other in the early exchange of information and to consider and engage in settlement discussions. Lord Woolf explained that the protocols were 'intended to build on and increase the benefits of early but well-informed settlements which genuinely satisfy both parties to a dispute'.[22] During his review, Sir Rupert Jackson found that the desired aims of the protocols were, on the whole, being achieved.[23]

Academic opinion on the significance of ADR within the civil justice system has traditionally been divided. Andrews has praised mediation and its growing status within the English civil justice system. He contends that mediation 'is a pillar of civil justice' and goes so far as to suggest that 'mediation is a valuable substitute for civil proceedings, or at least a possible exit from such proceedings'.[24] The increased use of mediation has, in Andrews' opinion, resulted in 'a significant reduction in litigation before the ordinary courts, especially in the High Court'.[25] Others have been more critical of ADR. Genn has expressed reservations in the increased promotion and acceptance of mediation by successive governments and the courts as a cheaper and quicker alternative to the court process. In her article 'What is Civil Justice For? Reform, ADR, and Access to Justice',[26] Genn, drawing on empirical data,[27] counters the 'unchallenged' notion that mediation is a cheaper alternative to the court process when she states:

> it is also clear that unsuccessful mediation may increase the costs for parties (estimated at between 1,500 and 2,000 pounds) and this fact raises serious questions for policies that seek to pressure parties to enter mediation unwillingly.[28]

The idea that cases that are diverted from the courts and into mediation contribute to access to justice is, according to Genn, weak because mediation is specifically non-court-based and, consequently, does not provide the parties with substantive justice. Further, the nature of mediation is such that it focuses primarily on the parties (with the assistance of the mediator) in reaching a settlement. It is not, Genn argues, about substantive justice between the parties. Rather, it is simply about settlement. As Genn puts it: 'The outcome of mediation, therefore, is not about *just* settlement it is *just about settlement*.'[29]

19 By CPR 1.3 the parties are also obliged to assist the courts in furthering the overriding objective.

20 CPR 1.4(2)(e).

21 For example, CPR 26.4 allows the parties to request a stay from the court in order to attempt settlement.

22 Woolf, Final Report (n 1).

23 Jackson, Final Report (n 7) ch 35, 352–3. For a critical evaluation of the Jackson proposal on the Practice Direction – Pre-action Conduct, see Masood Ahmed, 'An Alternative Approach to Repealing the General Pre-action Protocol' (2013) 32 Civil Justice Quarterly 256.

24 <www.dike.fr/IMG/pdf/Mediation_in_England_by_N_1_._H._Andrews_Cambridge_.pdf> accessed 7 January 2015.

25 Ibid.

26 Hazel Genn, 'What is Civil Justice For? Reform, ADR, and Access to Justice' (2012) 24(1) Yale Journal of Law and the Humanities 397.

27 Hazel Genn, *Twisting Arms: Court Referred and Court Linked Mediation under Judicial Pressure*, Ministry of Justice Research Series 1/07 (MoJ 2007).

28 Ibid.

29 Ibid (emphasis in original).

There is some truth in the arguement that a mediation which does not produce a settlement may increase costs for the parties. Disputing parties who have incurred costs in having to engage in an ADR process which has failed to produce a settlement will incur further costs in having to revert to the court process. Or, an unsuccessful ADR may simply be perceived by the parties as a necessary box-ticking exercise which must be completed before final judicial determination. In this regard it is interesting to note the operation of s 10 of the Children and Families Act 2014. That provision makes it mandatory for any party wishing to make a family application[30] to attend a family mediation, information and assessment meeting. At this meeting the parties are provided with information regarding the mediation of family applications, ways in which such matters may be resolved other than through the courts, and to assess whether the particular matter is suitable for mediation.[31] The obligation on the parties to engage in a process to effectively 'assess' whether mediation is appropriate may be seen by some as unnecessarily increasing costs and causing unnecessary delays to a process which is likely to revert to the courts in any event.

Fiss, a long-standing and ardent opponent of privatised adjudication, has compared settlement with plea-bargaining in the criminal law field. Fiss argues that settlement is:

> the civil analogue of plea bargaining: consent is often coerced; the bargain may be struck by someone without authority . . . Like plea bargaining, settlement is capitulation to the condition of mass society and should be neither encouraged nor praised.[32]

Fiss's analysis oversimplifies the nature and operation of ADR processes such as negotiation and mediation and their relationship with court adjudication. It paints a distorted picture where parties are forced to settle without any freedom of thought or right to object or walk away from the ADR process before a binding agreement is concluded. This does not fit well, for example, when one considers that sophisticated commercial parties, such as large multinational construction corporations, will often be represented by large and specialist commercial law firms who will have the skills and knowledge to engage in ADR processes and to advise their clients as to whether to continue with the process and, indeed, whether to enter into a settlement agreement. Further, negotiation and mediation are, by their very nature, consensual. The parties are at liberty to propose and enter into mediation. They are at liberty to broker an agreement but are equally free to remove themselves from the process before an agreement is concluded. A further concern with Fiss's argument is that it fails to reflect the changing norms within modern civil justice systems which incorporate ADR as an acceptable and valuable dispute resolution process which commercial parties, in particular, have agreed to incorporate within their written transactions as the preferred option to formal court adjudication.[33] Finally, Genn's contention that mediation is 'just about settlement' is also an oversimplification of the mediation models which currently exist. Genn's argument fails to take account of those ADR mechanisms such as judicial mediation which are common and popular in other common law jurisdictions, such as Canada, and which can, with the assistance of a judge who takes on the role of the mediator, offer the parties a greater understanding of the

30 S 10(3) Children and Families Act 2014 defines 'relevant family application' as 'an application that (a) is made to the court in, or to initiate, family proceedings; and (b) is of a description specified in Family Procedure Rules'.

31 Children and Families Act 2014, s 10(3).

32 Owen Fiss, 'Against Settlement' (1984) Yale Law Journal 1073. See also Owen Fiss, *The Law as It Could Be* (New York University Press 2003).

33 See *Flight Training International Inc v International Fire Training Equipment Ltd* [2004] EWHC 721 (Comm); [2004] 2 All ER (Comm) 568 in which the parties had agreed to incorporate an ADR clause into their contract and which was upheld and enforced by Cresswell J.

merits and weaknesses of their cases rather than serving simply as a settlement forum in which the parties are forced to settle.[34]

ADR has not been accepted in other jurisdictions as enthusiastically as it has been accepted in England.[35] In this regard it is interesting to note the comments of Lord Gill in his review of the Scottish civil courts.[36] Although recognising positive elements of mediation as an effective ADR mechanism, Lord Gill adopted a more cautious approach when reflecting upon mediation's role in civil justice. For Lord Gill, the emphasis remained firmly on the need to provide access to justice through the court system. Mediation is perceived as 'supplementing an effective court system, rather than being alternative to it'.[37] Lord Gill's observations and attitude towards ADR stand in stark contrast to the evolving approach that has been adopted by the judiciary and the government in England, which is to view ADR as occupying an increasingly significant role within the civil justice landscape.[38] Agreeing with Genn's contentions that we should not be indiscriminately attempting to drive cases away from the civil courts or compelling them, unwillingly, to enter into an additional process,[39] Lord Gill placed importance upon an efficient court system as providing the primary means of resolving civil disputes.[40]

There is no doubt that an efficient court system is the cornerstone of all civil justice systems. The principle that the courts are required to deliver justice is an obvious but fundamental one. In a system governed by law, the court's function is to uphold the law. In the civil context this means principally providing remedies for wrongs. In doing this, the *court* is required to ensure that substantive justice is achieved and substantive justice is, to borrow from Bentham, concerned with the court correctly applying right law to true facts.[41] However, Lord Gill's assessment of the relationship between the court process and ADR is, like Fiss's arguments, too simplistic in that it fails to take account of the evolving role and significance of ADR and its interrelationship with litigation. Aside from the economic advantages associated with ADR, it also has the benefit of narrowing the legal and factual issues between the parties if a settlement is not reached. The narrowing of issues is particularly effective after the parties have filed and served their statements of claim because it will provide the parties with a further opportunity to analyse the strengths and weaknesses of their respective cases with the assistance of a neutral third party (if, for example, mediation or conciliation is used) and to weigh the risks of continuing to litigate the matter to trial. This is especially true of early neutral evaluation in which the parties benefit from obtaining an assessment of the facts and legal issues by a third-party neutral which then serves as the basis of further negotiations and the likelihood of future

34 See, for example, the favourable comments of the Canadian Chief Justice Warren K Winkler, 'Some Reflections on Judicial Mediation: Reality or Fantasy?', University of Western Ontario, Faculty of Law, Distinguished Speakers Series <www.ontariocourts.ca/coa/en/ps/speeches/reflections_judicial_mediation.htm> accessed 11 March 2015.

35 See the discussion of ADR jurisprudence in Part 3 of this article.

36 Report of the Scottish Civil Courts Review <www.scotcourts.gov.uk/about-the-scottish-court-service/the-scottish-civil-courts-reform> 170 accessed 7 January 2015.

37 For example, Sir Bernard Rix, 'The Interface of Mediation and Litigation' (2014) 80(1) Arbitration 21.

38 See also similar comments by Lord Neuberger, 'Equity, ADR, Arbitration and the Law: Different Dimensions of Justice', 19 May 2010, Fourth Keating Lecture, Lincoln's Inn <www.civilmediation.org/downloads-get?id=98> accessed 7 January 2015.

39 Hazel Genn, *The Hamlyn Lectures 2008: Judging Civil Justice* (CUP 2008).

40 Report of the Scottish Civil Courts Review <www.scotcourts.gov.uk/about-the-scottish-court-service/the-scottish-civil-courts-reform accessed> 7 January 2015.

41 Jeremy Bentham, *Rationale of Judicial Evidence* in J Bowring (ed), *The Works of Jeremy Bentham* vol 6 (Edinburgh William Tait 1843).

settlement or it may assist the parties in avoiding unnecessary stages in the litigation process. The benefit of ADR as an 'issues-narrowing mechanism' may have a direct and relevant relationship with the court process if the matter does not settle, which is to assist the court and the parties to manage the case more effectively and efficiently. Therefore, ADR and the court process are distinctly interlinked and complement each other in the resolution of disputes. The court system must be efficient and ADR provides an important mechanism in assisting the parties and the courts to be efficient.

2 Court assessment of costs and adverse costs orders under the CPR[42]

In order to understand the relationship between the obligation on the parties to engage in ADR and the courts' powers to make adverse costs orders, we must appreciate some basic principles on costs.

There are two main principles that dictate which party should pay the costs of the proceedings. The first is that the costs payable by one party to another are at the discretion of the court; there is no automatic right to the recovery of costs.[43] The second principle is that the unsuccessful party will usually be ordered to pay the costs of the successful party; sometimes referred to as the usual costs order.[44] However, the court may decide not to make a usual costs order because, for example, the successful party's behaviour was unreasonable during the litigation process. In these circumstances, the court may decide to make an adverse costs order by restricting the amount of costs that the successful party may recover from the unsuccessful party. In deciding which adverse costs order to make, the court will have regard to a number of factors including the conduct of all the parties.[45] CPR 44.2(5)(a) elaborates that the 'conduct of the parties' includes conduct before, as well as during, the proceedings, in particular the extent to which the parties complied with the pre-action protocols. CPR 44.4(3) goes on to list a number of factors that the court must consider when assessing the *amount of costs* that must be paid. As with CPR 44.2(5)(a), CPR 44.4(3) includes having regard to the conduct of all the parties, including the efforts made, if any, before and during the proceedings in order to try to resolve the dispute.[46]

The next relevant provision is CPR 44.2(6) which sets out the adverse costs orders that can be made in substitute to the usual costs order. Those orders include an order that a party pays:

(a) a proportion of another party's costs;

(b) a stated amount in respect of another party's costs;

(c) costs from or until a certain date only;

(d) costs incurred before proceedings have begun;

(e) costs relating to particular steps taken in the proceedings;

(f) costs relating only to a distinct part of the proceedings; and

(g) interest on costs from or until a certain date, including a date before judgment.

42 Although costs are also assessed and awarded when applications are made during the litigation process, the analysis here is concerned with costs orders which are awarded after proceedings are concluded because the majority of the ADR jurisprudence concerning adverse costs orders involves the courts assessing costs at the end of trial and after carrying out an assessment of the behaviour of the parties before and after the litigation process.

43 Senior Courts Act 1981, s 51 and CPR 44.3(1).

44 Also known as 'costs follow the event'.

45 CPR 44.2(4)(a).

46 CPR 44.4(3)(ii).

The courts are given further powers under CPR 44.11(b) to make alternative costs orders where the conduct of one of the parties is found to be improper or unreasonable. If such conduct is found then, pursuant to CPR 44.11(2)(b), the court may order the party at fault or that party's legal representative to pay costs which that party or legal representative has caused any other party to incur.

CPR 44.2(6) has the effect of reflecting a court's displeasure about the conduct of the successful party. The courts' powers under CPR 44.2(6) also enable the courts to scrutinise behaviour before the parties formally engage the court process. As Lord Phillips commented, the rule 'radically changes the costs position'.[47] It does so because it permits the court to use liability in costs as a sanction against a party which unreasonably refuses to attempt ADR before the action begins. Furthermore, outside of the ADR sphere, the Court of Appeal in *Denton v HT White Ltd*[48] has strongly advocated the need for courts to adopt a more robust approach in making adverse costs orders when hearing applications for relief from sanctions pursuant to CPR 3.9.[49] Following *Denton*, it is expected that a party not in default of procedural requirements (party A) will cooperate with his counterparty (party B) who has breached his procedural obligations so that an application by party B to the courts for relief from sanctions will not be necessary. Where party A refuses to cooperate and, instead, adopts a tactical approach so as to benefit from party B's default, then party A can expect the courts to make a robust adverse costs orders against him under CPR 44.2(6). It is this approach, as will be considered later, which provides a new impetus for robust costs sanctions to be applied where the parties are required to consider ADR.

A final point to note is that the costs orders under CPR 44.2(6) (and if the party at fault is the successful party under CPR 44.11(2)(b)) relate specifically to the obligation of a successful party to pay at least some of the unsuccessful party's costs: POs. The rationale for having POs seems fair where an unsuccessful party has had to incur additional costs or time but for the successful party's failure to engage in ADR. However, as will be discussed in Part 3, the courts have been unwilling or reluctant to make POs against a successful party which has unreasonably refused ADR.

3 ADR jurisprudence and adverse costs orders: a critical assessment

This part will focus upon a number of significant Court of Appeal authorities, each of which concerns ADR. It will critically evaluate the relationship between judicial endorsement and reinforcement of ADR policy and reveal the extent to which this has been reflected in the types of adverse costs orders that the courts have eventually made. First we must consider those early post-Woolf authorities which were significant in not only adopting a pro-ADR stance but which also established the first jurisprudential connections between the court's role in encouraging ADR, the parties' obligations to consider and engage with ADR and the power of the courts to make adverse cost orders where the parties failed to engage with ADR.

The emergence of jurisprudence concerning the role of ADR (in particular mediation) in litigation became clearer shortly after the enactment of the CPR. These authorities

47 Lord Phillips in *Halsey* (n 6).

48 [2014] EWCA Civ 906.

49 CPR 3.9 (Relief from sanctions) provides: '(i) On an application for relief from any sanction imposed for a failure to comply with any rule, practice direction or court order, the court will consider all the circumstances of the case, so as to enable it to deal justly with the application, including the need – (a) for litigation to be conducted efficiently and at proportionate cost; and (b) to enforce compliance with rules, practice directions and orders.'

heralded a strong pro-ADR stance by the senior judiciary. In *Dyson v Leeds City Council*,[50] Ward LJ encouraged the parties to engage in ADR, which, he observed, was consistent with the overriding objective and the court's duty to manage cases. Also, in *Cowl v Plymouth City Council*,[51] Lord Woolf MR was of the view that the courts should make appropriate use of their 'ample powers' under the CPR to ensure that the parties try to resolve the dispute. He went on to indicate that the courts could require the parties to provide an explanation of the steps they had taken to try to settle the matter.[52]

The rhetoric for the need for parties to seriously consider and engage with ADR processes was taken a step further by Brooke LJ in the leading case of *Dunnett v Railtrack plc*.[53] In that case the Court of Appeal dealt with the issue of the defendant's unreasonable refusal to consider mediation. The defendant had been successful in defending an appeal by the claimant and sought its costs of the appeal, but had previously rejected an invitation by the claimant to seek a settlement through mediation. On appeal, the defendant, Railtrack, argued that it was not willing to engage in mediation as it was not willing to offer more than what it had previously offered by way of settlement. Brooke LJ did not hesitate in rejecting the defendant's arguments and refused to award its costs. He observed that the defendant had been wrong in rejecting mediation out of hand even though it did not consider that it would bring about a settlement of the matter. In Brooke LJ's opinion, this was a misunderstanding of the purpose of ADR. He emphasised the need for the courts to further the overriding objective through active case management, which included encouraging the parties to consider ADR procedures and for the parties to also further the overriding objective in this respect. In disallowing the defendant's costs, he concluded with a stern warning to lawyers who failed to consider and engage in ADR processes:

> It is to be hoped that any publicity given to this part of the judgment of the court will draw the attention of lawyers to their duties to further the overriding objective in the way that is set out in CPR Pt 1 and to the possibility that, if they turn down out of hand the chance of alternative dispute resolution when suggested by the court, as happened on this occasion, they may have to face uncomfortable costs consequences.[54]

Brooke LJ's judgment raises a number of points. The court adopted a favourable attitude towards settlement through ADR. Brooke LJ eloquently advocated the positive elements of ADR and, in particular, the skills and benefits of mediators in resolving disputes and their unique ability to achieve outcomes that may be beyond the scope of the court and lawyers. Further, although the court did not provide specific guidelines as to the assessment of unreasonableness, it adopted a strong policy approach in promoting ADR with the real threat of punishing a party in costs for failing to not only consider ADR but, more significantly, engage in it. Brooke LJ also mentions 'turn[ing] down out of hand the chance of ADR'.[55] It follows from this that regardless of whether a party considers ADR to be appropriate will be wholly irrelevant. Brooke LJ seems to indicate that if a court suggests ADR then the parties must consider ADR. Both observations are reinforced by Brooke LJ's concluding remark that is a threat of 'uncomfortable costs consequences' for parties who refuse ADR.

50 [2000] CP Rep 42, [16].

51 [2002] 1 WLR 803.

52 Ibid [3] (Lord Woolf MR).

53 [2002] EWCA Civ 303.

54 Ibid [15] (Brooke LJ).

55 Ibid [15] (Brooke LJ).

The earlier authorities illustrate the development of a pro-ADR judicial stance; one that was reinforced by the senior judiciary's advocacy for the need to make adverse costs orders in appropriate circumstances.[56] Therefore, the ground for the emerging ADR jurisprudence was fertile for subsequent decisions of the courts to further expand, develop and strengthen the link between judicial endorsement of ADR with effective and robust adverse costs orders that went beyond simply making CDOs. However, subsequent cases appeared to undermine the pro-ADR policy which consequently led to a clear discrepancy between the courts' endorsement of ADR on the one hand and on the other its failure to give proper effect to that endorsement though the making of appropriate and robust adverse costs orders. This is well illustrated by the controversial case of *Halsey*.

A great deal of criticism has been made in respect of the Court of Appeal's decision in *Halsey*. Some commentators, including members of the judiciary,[57] have criticised *Halsey* because of the guidelines given by the court as to when a party that has refused mediation will be perceived as unreasonable by the courts.[58] Others find *Halsey* unfair because it places a heavy burden on the party which contends that the other has unreasonably refused mediation to prove unreasonableness.[59] In fact, Ward LJ, who presided over the Court of Appeal in *Halsey*, recently recanted the court's decision when he said that it was time to review the *Halsey* principles that to oblige unwilling parties to refer their dispute to mediation would impose an unacceptable obstruction on their right of access to the courts.[60] The discussion here will focus on two interrelated issues. First, it will focus upon the Court of Appeal's contradictory understanding that the courts cannot compel parties to engage in mediation; that it breaches Article 6 of the European Convention on Human Rights (ECHR) which provides the right to a fair and public hearing. This, it is argued, places unnecessary obstacles in the development of ADR jurisprudence and illustrates reluctance on behalf of the courts to match their encouragement of ADR with robust cost orders. The second issue specifically relates to the court's approach to adverse costs orders.

Halsey concerned two personal injury cases that were heard together in the Court of Appeal. The critical issue was whether the defendants should be penalised in costs for refusing mediation. In both cases the claimants and the court had recommended mediation. The trial judges refused to take into account the defendants' refusal to mediate when assessing costs. The Court of Appeal upheld the decisions at first instance and held that the defendants should not be deprived of any of their costs on the ground that they had refused to accept the claimants' invitations to agree to mediation.[61]

Giving the judgment of the court, Dyson LJ explained in detail the duty of the courts under the CPR to encourage the parties to engage in ADR, the types of court-based mediation schemes which are available and recognised the virtues of mediation in relevant court guides.[62] However, on the question of whether the court has the power to order parties to submit their disputes to mediation against their will, Dyson LJ held that

56 For example, *Hurst v Leeming* [2001] EWHC 1051 (Ch); *Dyson v Leeds City Council* [2000] CP Rep 42; *Dunnett v Railtrack* (n 53); *McCook v Lobo and Others* [2002] EWCA Civ 1760; *Leicester Circuits* (n 7).

57 For example, Sir Gavin Lightman, 'Mediation: An Approximation to Justice' (2007) 73 Arbitration 400; Sir Anthony Colman, 'Mediation and ADR: A Judicial Perspective' (2007) 73 Arbitration 403; and more recently Rix (n 37).

58 For a discussion of the *Halsey* guidelines, see Shirley Shipman, 'Court Approaches to ADR in the Civil Justice System' (2006) 25 Civil Justice Quarterly 181.

59 Lightman (n 57).

60 *Wight v Michael Wright (Supplies Ltd)* [2013] EWCA Civ 498.

61 *Halsey* (n 6) [50] (Dyson LJ).

62 For example, the Chancery Guide and the Admiralty and Commercial Court Guide.

for a court to require unwilling parties to mediate would breach Article 6 of the ECHR. His Lordship stated:

> It is one thing to encourage the parties to agree to mediation, even to encourage them in the strongest terms. It is another to order them to do so. It seems to us that to oblige truly unwilling parties to refer their disputes to mediation would be to impose an unacceptable obstruction on their right of access to the court.[63]

Dyson LJ also held that, for a court to exercise its discretion on costs and impose an adverse costs order against a successful party, the burden is upon the party seeking the imposition of an adverse costs order to establish that the successful party acted unreasonably. The burden is not on the successful party to prove that its refusal to mediate was reasonable.[64]

Dyson LJ went on to recognise that the form of encouragement by the courts may be 'robust'. The strongest form of encouragement would take the form of an ADR order made in the Admiralty and Commercial Court.[65] Any party that fails to take part in ADR after a court order has been made or refuses to consider whether ADR is suitable will, Dyson LJ warned, be at risk of having an adverse costs order being made against it.

A number of observations can be made in respect of Dyson LJ's judgment. First, his Lordship makes brief reference to the earlier ADR cases of *Cowl* and *Dunnett* but fails to recognise that both authorities strongly favoured ADR and advocated the obligations of the parties to engage in ADR processes. A further difficulty with the court's judgment in *Halsey* relates to the notion that the courts cannot compel the parties to engage in ADR. The failure to recognise that this power exists, albeit impliedly through the threat of adverse costs orders, places a further obstacle in the way of ADR and the full realisation by the court of its powers to penalise a party through a range of costs orders including by way of POs. Dyson LJ fails to reconcile his opinion (although *obiter dicta*) that a court cannot compel mediation with Blackburn J's comments in *Shirayam Shokusan Company Ltd v Danovo Ltd*[66] and the approach taken by Arden J in *Guinle v Kirreh, Kinstreet Ltd*[67] in which the court made an ADR order despite one of the parties being unwilling to take part in ADR. Also, in *Phillip Garritt-Critchley*,[68] the district judge made an Ungley Order which required the parties not only to engage in mediation but also to provide witness statements to explain why a party refused to attend mediation. This act in ordering mediation and requiring sealed witness statements to be provided to the court is clear evidence of the courts' willingess to compel parties to engage in mediation regardless of the parties' opinions. Clearly, the Court of Appeal is not bound by the decision of the lower courts, however, Dyson LJ failed to consider two cases that dealt directly with one of the central issues in *Halsey* – can the courts compel unwilling parties to mediate? Despite Dyson LJ's *obiter* comments, *Shirayama* and *Guinle*, both High Court authorities, remain the law, albeit not followed in practice.

There also appears to be a paradox within Dyson LJ's reasoning as to the issue of encouragement of ADR by the courts. He purports to support his argument that the courts may encourage ADR in the form of, for example, an ADR order in the Commercial Court or an Ungley Order. If Dyson LJ contends that parties cannot be compelled to mediate, then his notion of court encouragement of ADR is contradictory. When one considers the wording of both the above orders it is clear that there exists an element of compulsion. The

63 *Halsey* (n 6) [9] (Dyson LJ).

64 Ibid [13] (Dyson LJ).

65 In the form set out in Appendix 7 to the Admiralty and Commercial Court Guide.

66 [2003] EWHC 3306 (Ch).

67 [2000] CP Rep 62.

68 *Phillip Garritt-Critchley v Ronnan* [2014] EWHC 1774 (Ch).

ADR order in the Commercial Court requires the parties to engage in ADR but also goes further and, in the event that the parties are unsuccessful in resolving their dispute through ADR, places a burden on the parties to provide reasons as to why the matter could not be settled. Therefore, it is argued that the concept of 'encouragement' of ADR by the courts is a term that is unclear and misleading in the light of the *Halsey* jurisprudence. What appears from *Halsey* is the court's desire to actively encourage ADR while at the same instance compelling parties to consider, engage and even settle their dispute with the threat of adverse costs consequences as the driving force in directing the court's approach.

Dyson LJ considered whether the court should make an adverse costs order against a successful public body on the grounds that it refused to agree to ADR. It was argued by the claimants that public bodies should be held to their ADR pledge following the High Court decision of *Royal Bank of Canada v Secretary of State for Defence*[69] in which the court stated that the ADR pledge should be given 'great weight'. Dyson LJ, who held that the judge in *Royal Bank of Canada* had been wrong to attach such weight to the ADR pledge, rejected this argument. The pledge, Dyson LJ explained, was no more than an undertaking that ADR would be considered and used in all suitable cases. If the case is not suitable for ADR, then a refusal to agree to ADR does not breach the pledge. There is logic in Dyson LJ's analysis of the ADR pledge. The pledge does not have the force of law; it is not a statutory requirement for public bodies to engage in ADR. But the issue is this: Dyson LJ appears to go to the opposite extreme when arguing that the ADR pledge was not relevant. Yes, to say that it must be given 'great weight' is to also go too far. But where a party invites a public body to mediation and does so within the context of a strong pro-ADR atmosphere, then the ADR pledge should have been taken into account when assessing the 'conduct' of the parties.

One of the main criticisms of *Halsey* is that it was fundamentally wrong on the issue that the court could not compel the parties to engage in mediation as it breached Article 6 of the ECHR. Sir Gavin Lightman[70] has convincingly argued that the court appeared to have been unfamiliar with the mediation process and to have confused an order for mediation with an order for arbitration or some other order which places a permanent stay on proceedings. An order for mediation does not interfere with the right to a trial: at most it merely imposes a short delay to afford an opportunity for settlement and indeed the order for mediation may not even do that, for the order for mediation may require or allow the parties to proceed with preparation for trial. Sir Gavin went on to state that the Court of Appeal appears to have been unaware that the practice of ordering parties to proceed to mediation regardless of their wishes was prevalent elsewhere throughout the Commonwealth, the USA and other jurisdictions.[71]

Further, the European Court of Justice's ruling in *Alassini v Telecom Italia SpA*[72] has made clear that the Italian law in question which required customers to engage in a form of compulsory mediation before they could bring legal proceedings did not breach Article 6. The Italian law, in the opinion of the Advocate General Kokott, pursued legitimate objectives in the general interest in the quicker and less expensive resolution of disputes. The measure of requiring parties to engage in settlement discussions before commencing court proceedings was proportionate because no less restrictive alternative existed to the implementation of a mandatory procedure since the introduction of an out-of-court settlement procedure which is merely optional is not as efficient a means of achieving those

69 [2003] EWHC 1841 (Ch).

70 Lightman (n 57).

71 For example, in Canada and Australia.

72 *Alassini v Telecom Italia SpA* (joined cases C-317-320/08) [2010] 3 CMLR 17 ECJ.

objectives. The Italian law did not seek to replace court proceedings and therefore access to the court was not denied but, at worst, delayed by 30 days.

Finally, although the Court of Appeal referred to the basic costs rules and the factors the courts will consider when assessing whether to make adverse costs orders, the court failed to provide guidance or comments upon the range of adverse costs orders that are at the disposal of the court. The claimants in both cases raised the argument that the defendants should be deprived of their costs and that was the order at the heart of the appeal. However, given the significance of the case and the precedent it was to set for future cases concerning ADR and the powers of the courts to make adverse costs orders, the Court of Appeal appeared to have fallen short in providing guidance on that issue. This shortcoming in *Halsey* is clearly illustrated when we come to analyse Briggs LJ's judgment in *PGF II SA v OMFS Company 1 Ltd*.[73]

The restraining force of *Halsey* upon judicial discretion to make appropriate adverse costs orders can be seen in *Burchell v Bullard*.[74] In that case Ward LJ expressed himself in the following way when commenting on the sums involved: 'A judgment of £5000 will have been procured at a cost to the parties of about £185,000. Is that not horrific?'[75] This was, he said, 'par excellence the kind of dispute which, as the recorder found, lends itself to ADR'.[76] He also found that the defendant's refusal to mediate had been unreasonable but, because the invitation to mediate pre-dated *Halsey*, Ward LJ did not impose cost sanctions even though he was of the view that the 'court should mark its disapproval of the defendants' conduct by imposing some costs sanction'.

In his Final Report, Sir Rupert also took the opportunity to expressly reject the notion of compulsory mediation when he said: 'In spite of the considerable benefits which mediation brings in appropriate cases, I do not believe that parties should ever be compelled to mediate.'[77] But despite this explicit rejection of compulsory mediation, his Lordship provided guidance as to the steps which courts could take to 'encourage' parties to participate in mediation, which included penalising the parties in costs. However, Sir Rupert's view on compulsory mediation or compelling parties to engage in mediation and subsequent guidance on encouraging mediation seems, like Dyson LJ's judgment in *Halsey*, to create a paradoxical approach towards compulsory mediation. It is this paradox which, coupled with the decision in *Halsey*, currently exists in English civil justice. On the one hand, the courts' official approach to mediation is that it should not be made compulsory but, on the other hand, judicial and extrajudicial statements indicate that there exists a form of compulsory mediation within the English civil justice system. Indeed, Lord Woolf alluded to the possibility of revisiting the idea of compulsory mediation when discussing his Interim Report in Hong Kong. Lord Woolf noted that, although he had not gone so far as to recommend compulsory mediation in the English system, he was 'encouraged to think that that is something which I should look at again'.[78]

Although subsequent Court of Appeal authorities continued to uphold the general pro-ADR policy, it is submitted that a closer examination of the facts of some of those cases indicates a lack of progress in expanding the wider range of costs orders even though the facts would justify such orders being made. This can be seen in the case of *Rolf v De*

73 [2014] 1 WLR 1386.

74 [2005] EWCA Civ 358.

75 Ibid [23] (Ward LJ).

76 Ibid [41] (Ward LJ).

77 Jackson, Final Report (n 7), ch 36, 355-356.

78 The Rt Hon the Lord Woolf, 'A New Approach to Civil Justice', 1996, Hong Kong Lecture.

Guerin.[79] In that case the claimant had made various invitations to the defendant to enter settlement discussions and, later, mediation which the defendant rejected. On appeal, when asked by the court why he had been unwilling to mediate, the defendant stated that if he had participated in mediation then he would have had to accept 'his guilt' and that he would not have been able to demonstrate to a mediator what the claimant's husband was like, as this could only be done at trial. In any event, he wanted his 'day in court'. Rix LJ did not hesitate in dismissing these reasons and found that the defendant's refusal to mediate was unreasonable behaviour for the purposes of CPR 44(5) and, as a consequence, the court was entitled to exercise its discretion and make no order as to costs.[80]

Although Rix LJ acknowledged that the courts have been unwilling to compel parties to mediate, his Lordship reinforced the trend that parties will be expected to consider and engage in mediation, and a refusal to do so will be considered as unreasonable behaviour which will justify the making of an adverse costs order against the defaulting party. Any reason for refusing mediation must be strong and grounded in the facts and law for it to withstand judicial scrutiny – any reason which is slightly weak will be dismissed by the courts and will amount to legitimate 'circumstances' in making an adverse costs order.

Rix LJ appears to take the approach that has developed through the jurisprudence in the area of ADR and mediation. His judgment confirms that, although mediation may not always produce a solution or a satisfactory solution for the parties, the court will expect parties to engage in mediation as a matter of course. A further observation relates to the costs order Rix LJ made. It was an order of no costs, that is, the successful defendant was deprived of claiming his costs. Upon closer examination of the facts it could be argued that the defendant's unreasonable conduct in pursuing the matter in order to have his 'day in court' rather than accept two offers to mediate by the claimant caused the claimant to unnecessarily remain in the litigation process and to incur costs as well as the time and resources of two courts. Indeed, Rix LJ made the point that there was a reasonable prospect that the mediation would have been successful. The court also noted that the claimant had also behaved unreasonably but, the fact remains, the claimant discharged her ADR obligations as required by the CPR and ADR jurisprudence. The defendant did not and there was a possibility that the matter would have settled without the need for the parties and the courts to incur further costs: a more robust costs order was required.

Some of the failures of *Halsey* concerning adverse costs orders and the reluctance of the courts to exercise their powers in making POs can be seen in *PGF*. The claimant, at an early stage in the litigation process, wrote to the defendant requesting that it participate in mediation and, four months later, the claimant sent a second letter inviting the defendant to ADR. However, the defendant failed to respond to these invitations and instead made a Part 36 offer without providing an explanation as to the basis of that offer.

The matter eventually settled, with the claimant accepting the defendant's Part 36 offer. Although the ordinary consequence of the claimant's acceptance of the defendant's Part 36 offer was that it would have to pay the defendant's costs for the relevant period unless the court ordered otherwise,[81] the claimant gave notice that it would seek an order for costs in its favour. At the costs hearing the claimant argued, inter alia, that the defendant was unreasonable to have refused to participate in ADR. The ADR point succeeded in part, in the sense that, while depriving the defendant of its costs for the relevant period, the judge did not accept the claimant's submission that it should also be paid its costs for that period.

79 [2011] CP Rep 24.

80 Ibid [41] (Rix LJ).

81 CPR 36.10(4) and (5).

Gross LJ gave permission to the defendant to appeal and the claimant to cross-appeal the ADR point on the ground that the application of *Halsey* to the facts might be of potentially wide importance.

Giving the leading judgment, Briggs LJ emphasised the importance of the role and success of ADR in settling civil disputes, especially after the Jackson reforms. Briggs LJ also noted that ADR conferred cost benefits to the parties and to court resources.[82] More significantly, Briggs LJ formally endorsed the advice given in the *Jackson ADR Handbook*[83] that silence in the face of an invitation to participate in ADR is, as a general rule, of itself unreasonable, regardless of whether an outright refusal, or a refusal to engage in the type of ADR requested, or to do so at the time requested, might have been justified by the identification of reasonable grounds.

The defendant also contended that the judge, having concluded that an offer of mediation had been unreasonably refused, mechanistically deprived the defendant of the whole of its entitlement against the claimant during the relevant period without weighing up all other relevant factors. The claimant, on the other hand, argued that the judge should have ordered the defendant to pay the claimant's costs in respect of the relevant period. Briggs LJ, agreeing with the defendant's arguments, observed that a finding of unreasonable conduct did not automatically result in a costs penalty. It is simply an aspect of the parties' conduct that needs to be addressed in a wider balancing exercise. It followed from *Halsey* and other cases that the proper response would be to disallow some or all of the successful party's costs. Briggs LJ also noted that *Halsey* did not recognise that the court might go further and order the otherwise successful party to pay all or part of the unsuccessful party's costs. Although Briggs LJ recognised that the court must, in principle, have this power, it would only be exercised in the most serious and flagrant failures to engage with ADR.[84] Therefore, the claimant's cross appeal was also dismissed.

Briggs LJ's judgment focuses upon the circumstances where a party refuses to respond to 'repeated' invitations to engage in ADR and this creates uncertainty. A better approach would have been for the Court of Appeal to have held that silence in the face of *any* invitation to engage in ADR would be considered as unreasonable and would justify the defaulting party being penalised in costs. Secondly, Briggs LJ suggested that it would be highly unusual for the costs sanction to take the form of requiring the party refusing mediation (i.e. the successful party) to pay some or all of the other party's costs: 'a sanction that draconian should be reserved for only the most serious and flagrant failures to engage with ADR'.[85] This approach is surely too cautious. It would be better if the court had acknowledged that an appropriate costs sanction is that a party in default of invitations to engage in ADR will be liable to pay the other's costs by way of a PO. Briggs LJ's observations that *Halsey* did not recognise that the unreasonable party may be ordered to pay the costs of the other party represents a missed opportunity in clarifying and reinforcing this area of law. Although *Halsey* did not deal with this issue, it did not prevent the Court of Appeal from exercising its powers, which Briggs LJ concedes the court would have, to make such an order on the facts of the case.

82 *PGF* (n 73) [24]–[30] (Briggs LJ).

83 Susan Blake, Julie Browne and Stuart Sime, *The Jackson ADR Handbook* (OUP 2013).

84 *PGF* (n 73) [51]–[52] (Briggs LJ).

85 Ibid [52] (Briggs LJ).

4 An alternative approach

This article has revealed the discrepancy that exists between judicial endorsement of ADR and the senior judiciary's reluctance to reflect that through the making of POs. The Court of Appeal's decision in *Halsey* undermines the evolution of adverse costs orders and continues to restrain judicial acceptance of its powers to compel parties to engage in ADR and to punish successful parties by way of POs. If the judiciary is committed to effect a change in litigation culture as envisaged by Lord Woolf, then that should be reflected through the making of appropriate robust costs orders (in circumstances which justify such orders being made) rather than simply paying lip-service to the general importance and benefits of ADR.

Judicial approaches to adverse costs orders against a successful party do not take account of the financial loss caused to the unsuccessful party. This is unfair and fails to strike an appropriate balance between the obligation of the parties to consider ADR and the need to reimburse a party that has complied with its obligation but which is now out of pocket as a result of the other party's default. This is not to say that every ADR process would have been successful and, therefore, would have saved the unsuccessful party litigation costs. However, one may reasonably argue that, had the parties engaged in ADR, then there is a strong likelihood that they would either have settled during the ADR process or at some point after it. Indeed, this is a line of argument the courts have raised in a number of significant ADR cases. In *Leicester Circuits Ltd v Coates Brothers plc*,[86] for instance, the Court of Appeal disapproved of the defendant's decision to withdraw from a mediation that the parties had arranged and rejected its argument that it would have been pointless to participate in it. Judge LJ was strongly of the conviction that, although it could not be assumed that the mediation would have succeeded, 'there [was] a prospect that it would have done if it had been allowed to proceed'.[87] More recently, Judge Waksman QC in *Phillip Garritt-Critchley v Ronnan*[88] granted an indemnity costs order against the defendants for unreasonably refusing to engage in mediation. He rejected the defendant's contention that the claim did not provide any middle ground between the parties and that the defendants were confident that an agreement could not be reached by engaging in the mediation process: 'To consider that mediation is not worth it because the sides are opposed on a binary issue, I'm afraid seems to me to be misconceived.'[89] It was only by sitting down and exploring settlement that the parties could really ascertain 'how far apart they really were.'[90]

How, then, can the gap between judicial encouragement and promotion of ADR be filled so that the courts, in appropriate cases, can utilise the full range of adverse costs orders including making a PO where a successful party has unreasonably refused to engage in ADR? It is submitted that two options may be considered to bring about a change. The first option demands the formal acknowledgment by the judiciary that it has the power to compel parties to engage in ADR: *Halsey* needs to be reappraised judicially and its approach rejected. The power to compel parties to engage in ADR would only be restricted to the point at which the courts order the parties to explore settlement through an appropriate ADR process; it would not, however, extend to compelling parties to actually settle their dispute through ADR. The exercise of this power would be underpinned by the obligation of the courts (and the parties) to further the overriding objective and the need for the

86 *Leicester Circuits* (n 7).

87 Ibid [27] (Judge LJ).

88 *Phillip Garritt-Critchley* (n 68)

89 Ibid [14] (Judge Waksman QC).

90 Ibid [22] (Judge Waksman QC).

courts to provide *proportionate* justice. Where the first option may prove to be too radical, then a second option may be considered. It rests on the need for the courts to make better use of their existing powers on costs and be more willing to make a PO where there has been an unreasonable refusal to engage in ADR. It is submitted that this option is reinforced by the Court of Appeal's recent approach on the issue of procedural non-compliance and relief from sanctions as formulated in the Court of Appeal authorities of *Mitchell v News Group Newspapers Ltd*[91] and *Denton*,[92] which have provided a new impetus for costs sanctions to be applied where ADR is concerned. Let us consider the two options in greater detail.

The first option is the most radical. It is radical because it demands a departure from the orthodox position in English civil procedure that ADR is not and should not be made compulsory. However, that orthodox position is untenable. Despite the formal rejection by senior members of the judiciary of the idea of court-compelled ADR, there is, as discussed in Part 3, evidence that the courts do compel parties to engage in settlement processes and that the parties run the risk of suffering by way of adverse costs orders where they have failed to engage in ADR or have unreasonably refused to engage in ADR. And this is well illustrated by the *Phillip Garritt-Critchley* case in which the district judge made an order in the following terms: 'the court considers the overriding objective would be served by the parties seeking to resolve the claim by mediation'.[93]

The courts' powers to compel parties to engage in ADR must be underpinned and guided by the overriding objective of dealing with cases justly and at proportionate cost. Although the courts have, in some cases, utilised the overriding objective in ordering that parties should consider ADR, the courts must make greater use of the overriding objective in seeking to provide the parties with *proportionate justice*. And the parties would also be required to assist the court in furthering the overriding objective as required under CPR 1.3. To understand and fully appreciate the concept of proportionate justice and how it relates to the first option, a more detailed analysis of the overriding objective is called for.

The overriding objective is the bedrock of the civil justice system. It underpins the CPR and guides the courts in the management of civil disputes and dispensing justice. When introduced by Lord Woolf, the overriding objective was revolutionary in transforming the concept of 'justice' from one which was primarily concerned with seeking to achieve substantive justice (or justice on the merits) between the parties to a broader concept of justice.[94] The courts could no longer simply be concerned with achieving substantive justice; this now had to be balanced with other considerations. As Lord Woolf MR explained: 'The achievement of the right result needs to be balanced against the expenditure of the time and money needed to achieve that result.'[95] Lord Woolf MR also spoke of the need to have proportionate justice and this meant that no more than proportionate costs should be expended on individual cases – the courts had to consider the rights of other litigants to have access to justice.[96] This was taken further under the Jackson reforms, which amended the Woolfian overriding objective to give express recognition to the principle of

91 [2013] EWCA Civ 1537.

92 *Denton* (n 48).

93 *Phillip Garritt-Critchley* (n 68) [6] (Judge Waksman QC).

94 The pre-Jackson overriding objective under CPR 1.1(1) stated: 'These rules are a new procedural code with the Overriding Objective of enabling the court to deal with cases justly.'

95 Woolf, Interim Report (n 1) ch 4, para. 6.

96 See Lord Woolf MR's comments in *Beachley Property Ltd v Edgar* [1997] PNLR 197.

proportionality within CPR 1.1(1)[97] and the obligation on the parties to comply with rules, practice directions and court orders.

Therefore, the overriding objective is concerned with the need to achieve proportionate justice as opposed to simply seeking to achieve substantive justice between the parties. The courts must consider the rights of other litigants to have access to justice. Sorabji explains that the policy aims of time and cost are intended to support the achievement of the wider public policy aim of ensuring that the limited resources allocated by the state to the justice system can be distributed fairly amongst all who rely on the state to vindicate and enforce their rights and obligations.[98] Thus, Sorabji argues, the new theory of justice is concerned with securing *distributive* justice rather than justice on the individual merits of the case. As a consequence, litigants are provided with a system of judicial resolution of disputes that ultimately seeks to achieve proportionate justice.

Applying the overriding objective, the courts must seek to further the principle of proportionality when considering whether a particular dispute is suitable for ADR. It may be that the facts and issues of a particular case are such that justify it being resolved through mediation rather than incurring court resources in allowing the matter to be pursued through the court process. By doing this, the courts will be effectively applying and furthering the overriding objective in ensuring that the parties are provided with proportionate justice.

The second option has two elements:

1. the need for the removal of artificially high and unrealistic thresholds that restrict the making of POs and greater use by the courts of their cost powers;
2. to reinforce element 1 above, amending the costs rules to make clear that, when assessing costs, the courts will have regard to ADR as an important cost-saving mechanism for the parties and the court.

There must be a fundamental change in judicial attitudes and approaches to the making of adverse costs orders and the removal of artificially high thresholds in making POs. Although Briggs LJ in *PGF* suggested that the courts possessed the powers to make POs against successful parties, his Lordship immediately restricted this by setting a high threshold of 'flagrant breaches' which, if met, would justify an order being made. However, this test is vague, artificial and contradictory. It is unclear as to what is actually meant by 'serious and flagrant breaches'. The fact that the Court of Appeal did not expand on the circumstances where the test would apply (whether by way of non-exhaustive examples or by providing factors which the courts would take into account when applying the test) does not assist in the theoretical understanding of the test and its practical application. It is contradictory because, as argued, repeated invitations can reasonably be interpreted as a 'serious and flagrant breach' of the parties' duties to consider and engage in ADR and therefore would justify the making of a PO against the successful party. Further, the test does not sit well with the policy of ADR consistently advocated by the courts. If, as Dyson LJ stated in *Halsey*, the most robust form of encouragement would be an ADR order, then surely, where a successful party had refused ADR unreasonably after such an order had been made, that conduct in itself should justify the making of an equally robust costs order in the form of a PO. Although Dyson LJ did not, as Briggs LJ rightfully observed in *PGF*, discuss POs in *Halsey*, the court in *PGF* was in a position to not only formally acknowledge

97 For an interesting discussion of the concept of proportionality, see J Sorabji, 'Prospects for Proportionality: Jackson Implementation' (2013) 32(2) Civil Justice Quarterly 213.

98 John Sorabji, *The Woolf and Jackson Reforms: A Critical Analysis* (CUP 2014).

that the courts have the powers to make POs, it should also have made such an order, which was justified on the facts. This would have bridged the gap that currently exists between strong judicial endorsement of ADR and the making of cost orders that reflect and reinforce that endorsement.

It may be argued by some that Briggs LJ's (overly) cautious approach is justified on the grounds that POs are too heavy handed, too draconian and, in any case, the courts are able to make CDOs which serve the purpose of penalising a successful party in costs. However, this argument unduly restricts the court's discretion and its powers to exercise the full range of adverse costs orders. The powers to make a range of adverse costs orders have been provided to the courts by the CPR and are there to be utilised and should be utilised in appropriate cases. This approach is supported by the Court of Appeal's robust stance concerning circumstances in which a party has failed to cooperate with its counterpart which has breached a process requirement and is forced to make an application for relief from sanction under CPR 3.9.

The landmark cases of *Mitchell MP and News Group Newspapers*[99] and *Denton* dealt with the issue of the approach the courts should adopt where a party has failed to comply with process requirements and then makes an application for relief from sanctions. In both cases the court advocated the need to adopt a more robust and less forgiving stance when considering applications for relief from sanctions. In particular, in *Denton* the court advocated the need to adopt robust judicial approaches in making adverse costs orders to penalise a party that failed to behave reasonably in agreeing to extensions of time or that unreasonably opposed applications for relief from sanctions.[100] This behaviour, the court noted, ran counter to the duty of the parties to further the overriding objective. Giving a joint judgment of the court, Lord Dyson MR and Vos LJ made clear the need for the courts to make heavy costs sanctions which went beyond simply requiring the unreasonable party to pay the cost of the application when they stated:

> [T]he court will be more ready in the future to penalise opportunism. The duty of care owed by a legal representative to his client takes account of the fact that litigants are required to help the court to further the overriding objective . . . Heavy costs sanctions should, therefore, be imposed on parties who behave unreasonably in refusing to agree extensions of time or unreasonably oppose applications for relief from sanctions.[101]

The court also held that an unreasonable party would not only be required to pay the costs of the application for relief but it may also be required to suffer further cost sanctions (by way of a CDO) at the end of the proceedings even though it may be the successful party. Although the Court in *Denton* spoke of CDOs being made against the successful party, the principle that a more disciplinarian approach be adopted, which requires the making of 'heavy costs sanctions', is one that lends support to the argument that the courts should also adopt an equally robust approach to costs when dealing with ADR. This would include the courts making costs orders which have the aim of reimbursing the unsuccessful party for costs it has incurred because of the successful party's unreasonable behaviour in refusing to engage in ADR.

The second element of the second option requires the rules on costs to be amended so that they make clear that the court will have regard to factors which *could have saved the parties and the court costs* when considering whether to make adverse costs orders. Having such a

99 *Mitchell* (n 91).

100 CPR 3.9 deals with applications for relief from sanctions.

101 *Denton* (n 46) [43] (Lord Dyson MR and Vos LJ).

provision has the benefit of providing the courts with a general power to take into account any relevant steps the parties could have taken (but failed to take) during the litigation process that could have saved the parties and the courts cost and time. This provision would further justify the courts making POs in circumstances where the successful party could have engaged in ADR but failure to do so has meant that both parties have had to incur further costs in the matter continuing to be pursued through the court process. The following approach could be adopted from the Singaporean civil justice system.

Although ADR is not mandatory in Singapore, the Subordinate Courts have implemented a 'presumption of ADR' for civil matters. This expressly endorsed the early use of ADR. The effect of the presumption is that cases filed in the Subordinate Courts are *automatically* referred to the most appropriate mode of ADR unless any or all of the parties opt out of ADR.[102] Although the parties may opt out, they risk being punished in costs at a later stage. Order 59 rule 5(1)(c) of the Rules of Court[103] prescribes the types of orders that can be made:

> The Court in exercising its discretion as to costs shall, to such extent, if any, as may be appropriate in the circumstances, take into account the parties' conduct in relation to any attempt at resolving the cause or matter by mediation or any other means of dispute resolution.

The courts have further extensive powers to penalise a party in costs for misconduct or neglect under Order 59 rule 7, which would include a party's failure to engage in ADR. Order 59 rule 7 states:

> (1) Where it appears to the Court in any proceedings that anything has been done, or that any omission has been made, unreasonably or improperly by or on behalf of any party, the Court may order that the costs of that party in respect of the act or omission, as the case may be, shall not be allowed and that any costs occasioned by it to *any other party shall be paid by him to that other party.*[104]
>
> (2) Without prejudice to the generality of paragraph (1), the Court shall for the purpose of that paragraph have regard in particular to the following matters:
>
> *(a) the omission to do anything the doing of which would have been calculated to save costs.*[105]

The Singaporean system is interesting because its costs regime is better linked to its strong commitment to the parties' obligation to engage in ADR. The 'presumption of ADR' referral system acts as a form of quasi-compulsory mediation in that an automatic referral will be made but the parties still have the freedom to opt out, albeit at the risk of a costs order being made against them at a later stage. The Singaporean approach also goes further than the English approach in that it formally recognises the courts' role in serving society with a 'variety of processes for timely resolution of disputes'. This radically alters the traditional perception of the role of the courts from one in which courts are perceived as

102 Subordinate Courts Practice Direction Amendment No 2 of 2012. Relevant amendments were also made to the pre-action protocols for non-injury motor accident, medical negligence and personal injury claims to ensure that the schemes would be in alignment with the guidelines for a 'presumption of ADR'. The 2012 presumption of ADR was followed with the passing of the State Courts Practice Directions Amendment No 4 of 2014 <https://app.statecourts.gov.sg/Data/Files/file/cdr/PD%20Amendment%20No%204%20of%202014.pdf>. These amendments expand the presumption to apply to cases that are called for pre-trial conferences four months after the writ is filed. Amendment No 4 took effect in August 2014.

103 Supreme Court of Judicature Act (chapter 322, s 80), Rules of Court, R5 GN No S 71/1996, revised edn 2014 (21 March 2014).

104 Emphasis added.

105 Emphasis added.

principally concerned with dealing with litigation to one which views their role in a more dynamic way, as a service provider of other methods of dispute resolution. By contrast, Zuckerman has contended that the function of the civil court is to deliver a public service for the enforcement of rights rather than merely a dispute resolution process.[106] Unlike the Singaporean system, which speaks of the courts providing a 'variety' of processes for the resolution of disputes, Zuckerman warns of the danger of regarding courts as one form of dispute resolution when he states: 'to regard court adjudication as simply one of many forms of private dispute resolution is to debase its constitutional function in a system governed by the rule of law . . . Court adjudication is the process which provides citizens with remedies for wrongs that they have suffered.'[107]

Order 59 rule 5(1)(c) reflects Singapore's strong ADR commitment because it makes specific reference to mediation and ADR generally. The equivalent provision under the English costs regime, CPR 44.4 (3)(ii), rather than expressly mentioning a particular type of ADR procedure, simply refers to the parties' conduct in 'trying to resolve the dispute'.

Despite these differences, the Singaporean cost regime does bear some similarities to the English system. Order 59 rule 7(1) includes what appears to be POs, which oblige a party found to have caused another party to incur unnecessary costs to reimburse those costs. But Order 59 rule 7(2) goes further than the English system. Order 59 rule 7(2) provides guidance on Order 59 rule 7(1) by setting out factors the court can take into account when exercising its discretion and these include the failure of a party to do anything that *would have saved costs*. As discussed, ADR procedures are generally perceived as cost-saving mechanisms when compared with the court process and therefore it would follow from the wording of Order 59 rule 7(2) that a failure to engage in ADR would be considered as saving costs. An equivalent provision to Order 59 rule 7(2) is missing under the CPR which, if included, would make clear to all who engage in the civil justice system that the courts will consider potential cost-saving steps, such as ADR, that could have saved costs when the court considers making costs orders. Indeed, a provision which incorporates the principle of causation, similar to Order 59 rule 7(1), thereby links the failure of one party to engage with ADR with the financial loss suffered to the other party (including the adverse impact this may have on finite court resources). Some support for this proposition can be taken from the Court of Appeal decision in *Arkin v Borchard*.[108] That case concerned an impecunious claimant and the issue was whether the successful defendants could recover their costs from a third-party funder of the claimant. Confirming that the defendants could pursue the third party, Lord Phillips was of the view that causation was a significant factor in justifying a costs order against a non-party. His Lordship explained:

> Causation is also often a vital factor in leading a court to make a costs order against a non-party. If the non-party is wholly or partly responsible for the fact that litigation has taken place, justice may demand that he indemnify the successful party for the costs that he has incurred.[109]

It is argued that a direct link between a party's failure to engage with ADR and the financial loss suffered to the other party (which may be the unsuccessful party) will reinforce and clarify the court's wide-ranging costs powers.

This article has revealed a paradoxical situation which currently exists within ADR jurisprudence: the discrepancy between strong and enthusiastic judicial endorsement of

106 Adrian Zuckerman, *Civil Procedure Principles of Practice* (Sweet & Maxwell 2013).

107 Ibid 1.6.

108 *Arkin v Borchard* [2005] EWCA Civ 655.

109 Ibid [24] (Lord Phillips MR).

ADR but a failure on behalf of the senior judiciary to reflect this by making appropriate adverse costs orders, especially POs. There is a need for a change in judicial attitudes towards compulsory mediation, more effective utilisation of the overriding objective and greater use by the courts of their costs powers when dealing with ADR within the civil justice system.

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Constitutionally questioned: UK debates, international law and Northern Ireland

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Abstract

This comment examines the proposed UK constitutional changes proffered following the no vote in the Scottish independence referendum from an international legal perspective. With a particular focus on the implications for Northern Ireland, this piece considers the possible consequences of further devolution, proposed federalism, changes to the UK's relationship with the European Convention on Human Rights (ECHR), modifications of relations with the European Union (EU) and the potential effects of change to the relationship with the Republic of Ireland. In looking at these issues through the lens of international law, this comment brings a fresh perspective to questions of constitutional change for Northern Ireland.

Key words: constitutional change; devolution; federalism; self-determination; European Convention on Human Rights; border poll; European Union.

Introduction

Northern Ireland has been the catalyst for several UK constitutional upheavals.[1] As the first region to achieve devolution in 1921, Northern Ireland established the UK prototype. Yet, one hundred years after the first set of Home Rule crises, the region is once again a fulcrum for the re-ordering of the UK's constitutional structures.[2] While a referendum on Scottish independence provided political impetus for the current constitutional debates, in many ways Northern Ireland provides both a point of reference and of complication for constitutional analyses. Indeed, Northern Ireland's devolutionary experiences of disentangling competing interests provide ample basis for discussion.[3] On the other hand, the particularities of the Northern Irish situation mean that proposed constitutional changes such as exiting the EU or the ECHR require special attention. The

* Our thanks to Kevin J Brown (Queen's University Belfast), C R G Murray (Newcastle University) and Se-shauna Wheatle (Durham University) for their advice and comments on earlier drafts. All errors remain our own.

1 For example, Northern Ireland hosted the first of the UK's devolved administrations and the UK Human Rights Act 1998 in part owes its existence to the Belfast Agreement 1998 (also known as the Good Friday Agreement) available at <www.gov.uk/government/publications/the-belfast-agreement> accessed 18 November 2014.

2 Government of Ireland Act 1920; Northern Ireland (Emergency Provisions) Act 1973; Alvin Jackson, *Home Rule: An Irish History, 1800–2000* (OUP 2003).

3 Northern Ireland Constitution Act 1973; Northern Ireland Sovereignty Referendum 1973; Northern Ireland Act 1998.

need for UK political, economic and legal actors to take account of historical experience as well as the implications of proposed changes for Northern Ireland should be more widely acknowledged.[4]

Vast arrays of interconnected[5] constitutional changes are being discussed and pressed forth, including: Scottish independence;[6] increased powers for devolved governments;[7] an English or regional assembly;[8] a UK 'senate' chamber;[9] reformed relationships with human rights[10] and with the EU.[11] With such rapid and broad changes being proposed, a number of themes have, thus far, failed to attract the attention they require. For example, a variety of external and internal outcomes will influence and result from such constitutional change. If regarded from an international legal angle, we argue, greater clarity can be brought to the variety of outcomes that might result from constitutional disruption. It is this international legal, rather than purely domestic, perspective that this article takes in considering the variety of proposed changes.

First, this article will frame the need for international lawyers' analyses of the UK's constitutional debates. It will do so by highlighting the multitude of concealed agendas that currently dominate domestic politics, and which are driving various 'reform' agendas. The piece then moves on to examine some of the broader themes that underlie discussions on constitutional changes, such as the notions of self-determination, devolution and federalism. The international complications that Northern Ireland brings to current debates are then considered. Finally, the impact that these changes may have for the UK as a global actor is addressed. The general approach of the article is to contest the current misguided tendencies to define important constitutional changes by sole reference to internal factors. This tendency, it will be shown, neglects the significant external implications of 'internal' debates. Instead, the changes to the UK's constitutional settlement must, it is argued, be situated in the broader regional and international political and economic context. The exigencies of modern globalisation and commerce mean that external bodies and countries are both influenced by and influencers of 'internal' debates.

4 For example, the potential impacts of the the Conservative Party's naming of a 'British' Bill of Rights, <www.telegraph.co.uk/news/politics/conservative/11136146/A-British-Bill-of-Rights-should-be-welcomed.html> accessed 18 November 2014.

5 For example, the threat of Scottish independence is clearly a factor in the offer of increased powers for devolved governments, which itself is clearly linked to debates about a new English assembly. An exit from the EU and the ECHR is more predominantly an English concern and such disjuncture between Scottish and English political identity undoubtedly influences debates on independence.

6 Fiona Hyslop (Cabinet Secretary for Culture and External Affairs), 'The Scottish Referendum, and the Prospects for Constitutional Reform', 30 October 2014 <http://news.scotland.gov.uk/Speeches-Briefings/The-Scottish-referendum-and-the-prospects-for-constitutional-reform-1216.aspx> accessed 18 November 2014.

7 Secretary of State for Scotland, 'The Parties' Published Proposals on Further Devolution for Scotland', October 2014, Command Paper 8946.

8 Lord Wallace of Tankerness, 'Scotland: Devolution – Motion to Take Note', HL Deb, 29 October 2014, col 1293.

9 'Elected Senate Would Replace House of Lords under Labour', BBC News: Politics, 1 November 2014, <www.bbc.co.uk/news/uk-politics-29857849> accessed 18 November 2014.

10 'Protecting Human Rights in the UK: The Conservatives' Proposals for Changing Britain's Human Rights Law' <www.conservatives.com/~/media/Files/Downloadable%20Files/HUMAN_RIGHTS.pdf> accessed 18 November 2014.

11 David Lidington MP, 'A Constructive Case for EU Reform', 13 December 2013, <www.gov.uk/government/speeches/a-constructive-case-for-eu-reform> accessed 18 November 2014.

Discussing change: don't judge a book by its cover

Current constitutional ruminations have largely been shaped by a number of concealed agendas. Rather than defining constitutional debate by reference to the many international examples of power division, federal governance and devolution-type settlements, the UK's constitutional debate has been drawn on introverted constitutional debates. Each agenda represents different threats and opportunities for the regions. For instance, within England, the electoral fortunes of political parties lurk beneath the surface of proposed changes to voting within the Westminster Parliament. The removal or reduction of the voting powers of Scottish, Northern Irish and Welsh MPs is not only significant for the governance of the regions, but also has the potential to redraw the party political status quo.[12] Although best known for arguing for independence from external entities such as the EU and the ECHR, the rise of the UK Independence Party (UKIP) has been significant in magnifying desires for internal autonomy and internal self-determination.[13] For instance, on the 'English votes for the English' question, the party has added pressure to mainstream political parties and shaped agendas.[14] The recent swift decision by the UK government in concert with Greater Manchester Council's move to introduce a mayor for Manchester, despite voters in Manchester having rejected this in 2012, is a further example of this rush to change the current settlement.[15]

In Scotland, a significant proportion of the concealed agendas belong(ed) to the markets. Dominant economic actors vocally campaign(ed) against independence on the basis that it would harm jobs and the prosperity of Scots.[16] This was an important consideration for many, but, for the boards of directors and chief executive officers making the threats,[17] it was not the primary motivation. Rather, in furthering the aims of their boards of directors and shareholders, the threat to the stability of markets and the broader business environment was the unspoken motivation for such a fight against Scottish independence.

Whilst in Northern Ireland the potential reopening of the settlement forged under the Good Friday Agreement is both a threat and a potential opportunity, much remains unsaid. There is fear of concealed and/or incremental changes that erode cultural identities,[18] and

12 Puerto Rico serves as a useful example of representation without voting rights: Dorian Shaw, 'The Status of Puerto Rico Revisited: Does the Current US–Puerto Rico Relationship Uphold International Law' (1993) 17 Fordham International Law Journal 1006.

13 David Breed, 'Euroscepticism in Britain: Social Movement or Contentious Politics?' (2013) 1 Praxis: Politics in Action 74, 82 and 86.

14 UKIP, although holding little formal power, has been significant in using soft power to shape policy and debate: ibid.

15 City of Manchester (Mayoral Referendum) Order 2012, 329/2012; Local Authorities (Mayoral Elections) (England and Wales) (Amendment) Regulations 2014, 370/2014; details at <www.gov.uk/government/uploads/system/uploads/attachment_data/file/369858/Greater_Manchester_Agreement_i.pdf> accessed 18 November 2014.

16 An illustration of the (financial) commitment to a no vote is visible in the list of corporate donors to the campaigning groups: Electoral Commission, 'Donations and Loans Received by Campaigners at the Referendum on Independence for Scotland (Pre-poll Reporting: 18 December 2013 to 26 June 2014)' (2014). <www.electoralcommission.org.uk/__data/assets/electoral_commission_pdf_file/0009/169425/2014-pre-poll-donations-and-loans-2014-07-03-deadline.pdf> accessed 30 October 2014.

17 See e.g. RBS statement days before the Scottish referendum: 'Contingency Planning for Scottish Independence Referendum' <www.rbs.com/news/2014/09/statement-in-response-to-press-speculation-on-re-domicile.html> accessed 18 November 2014.

18 A fear that is perhaps inherent in a power-sharing arrangement that allows for some, but not total, 'cultural autonomy': Donald L Horowitz, 'Explaining the Northern Ireland Agreement: The Sources of an Unlikely Constitutional Consensus' (2002) 32 British Journal of Political Science 193, 194.

politics remains an ongoing battle between two sides conjoined in government with little substantial opposition. Besides the internal 'blockages'[19] that these issues cause, there are also external implications. In particular, such internal paralysis has had repercussions for Northern Ireland's voice in debates on human rights, economic powers and the division of power in the UK. This is crucial, as a strong voice within the UK affects Northern Ireland's capacity to deal with the issues of austerity, social security, rural and urban poverty, policing and employment.

There is a danger that the questions of new constitutional settlements and the accompanying (re)division of power are determined without reference to these concealed agendas. This is likely to lead only to a transient solution to the multiple divergent desires within the UK. It also risks the concealed becoming overt in unpredictable ways. For example, the Conservative agenda for England might lead to cross-party stalemate and the stalling of progress for Scotland. For Scotland, it might be argued that various conspiracy theories and the growth of the #the45 movement (a continuity movement demanding change on the basis of the 44.7 per cent of 'yes' voters) emerged due to the unease at apparent hidden influences. And for Northern Ireland, the stability of the current settlement is jeopardised.

Underlying debates

Self-determination is in vogue in the (still-)United Kingdom albeit within the UK-wide debate it is rarely expressly invoked. Self-determination sits at the heart of debates on the UK's relationship with the ECHR and the EU, Scottish independence, further devolution and border polls. The principle is widely recognised in international law and has roles in shaping both internal socio-political debates and in supporting claims for full independence.[20] The self-determination principle is one that has been well tested in international law, having negotiated many difficult internal power-division and secession settlements. As such, it is a potent concept that has resonance for the UK's current precariousness. In particular, self-determination emphasises the importance of (geographic, social, political, economic) settlements that reflect the desires of the people. Put differently, to meet the demands of self-determination whatever settlement comes next for the various regions that comprise the UK, it must 'work' for each of them whether this is external (full independence) or internal (a spectrum of governance models within a state) in form.

Self-determination is the grant to a people of a right to determine their own governance mode (a finely balanced right within the UK). Federalism brings decision-making closer to individuals (a form of localism) and also moves each unit towards a position of equality. Yet devolution is more likely to take account of the needs of a particular geographical region and facilitates a clearer reproduction of the advantages of differing forms of governmental control. In asking settlement questions in terms of international self-determination (both external and internal), rather than in terms of historical reminiscences of nationhood or political manoeuvring, a more fruitful discussion may emerge. Considering Northern Ireland's experience of international legal settlements (the emergence of the Free State and the Good Friday Agreement between the UK and Ireland), it could provide leadership to the rest of the UK in this regard.

19 Statement by UK Prime Minister David Cameron, 'The Prime Minister David Cameron Made a Statement Ahead of Resumption of Talks at Stormont in Northern Ireland Today' <www.gov.uk/government/news/pm-statement-ahead-of-resumption-of-talks-in-northern-ireland> accessed 18 November 2014.

20 UN Charter, Article 1.2; Milena Sterio, *The Right to Self-determination under International Law: 'Selfistans', Secession and the Rule of the Great Powers* (Routledge 2013).

The two predominant models – devolution and federalism – for the division of powers amongst either nations or geographical areas are often tied to the notion of internal self-determination.[21] Devolution and federalism[22] both have pluralist tendencies,[23] whilst neither system is clearly or rigidly defined.[24] While devolution is the current approach to the division of power in the UK,[25] federalism offers an alternative political settlement that forms a responsive basis for many stable and successful states. The historical rationales for choosing (at least the terminology of) devolution over federalism is likely linked to the emergence of Home Rule for Ireland in the late nineteenth century. Those nineteenth-century debates used federalism as a bargaining chip in a contentious negotiation,[26] and thus a concept of devolution provided a less 'loaded' route for the Northern/Irish negotiations. Indeed, the fragmentation of the UK (from the Republic's choice of external self-determination to Northern Ireland's choice of internal self-determination) is an often-neglected example within international law of how states achieve differing forms of governance autonomy.[27] Current discussions give some scope for questioning this trust in devolution.[28] Whilst a clear division between devolution and federalism is impossible, in general, federalism maintains the equal division of power amongst constituent units, holds governance at a particular level and maintains the same relationship between the centre and with each unit. Devolution reflects a diversity of arrangements and varies according to the strength of the downward governance push and the local needs of a population. This causes the relationship with the centre to vary as between units. As such, federalism oversees the relationship between specific points of governance, the constituent units of the federation are equivalent and held in a symmetric fashion. By contrast, devolution can include a cacophony of options and relationships with the centre.

Alongside the existing UK arrangements, this could include 'devolution' to cities such as London and Manchester or to new Northern English Assemblies as well as the existing units.[29] In both devolution and federalism, although power is not centralised,[30] a central authority usually keeps control of defence and some, though not necessarily all, foreign

21 Christian Walter, Antje von Ungern-Sternberg and Kavus Abushov (eds), *Self-determination and Secession in International Law* (OUP 2014); John Loughlin, John Kincaid and Wilfried Swenden (eds), *Routledge Handbook of Regionalism and Federalism* (Routledge 2013).

22 Baron de Montesquieu, *The Spirit of Laws* (1748); Nicolaidis Kalypso and Robert Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the US and the EU* (OUP 2001); Vernon Bogdanor, *Devolution in the United Kingdom* (OUP 2001).

23 Robert Schütze, 'Federalism as Constitutional Pluralism: Letter from America' in Mattej Avbelj and Jan Kommarek (eds), *Constitutional Pluralism in the European Union and Beyond* (Hart 2012) 185–212; Roderick Hills, 'Is Federalism Good for Localism: The Localist Case for Federal Regimes' (2005) 21 Journal of Law and Policy 187.

24 See e.g. Guy Peters, 'The United Kingdom becomes the Untied Kingdom? Is Federalism Imminent, or Even Possible?' (2001) 1 British Journal of Politics and International Relations. Bogdanor (n 22) defines the differences between federalism and devolution as the contrast between a system that divides rather than devolves power between parliaments.

25 One author notes that the UK's settlement has 'nothing in common with federalism': Archie Brown, 'Asymmetrical Devolution: The Scottish Case' (1998) 69 Political Quarterly 215, 215.

26 See Bogdanor (n 22).

27 Norman Davies, *Vanished Kingdoms: The History of Half-Forgotten Europe* (Allen Lane 2012) 635.

28 Nicholas Mansergh, *The Government of Northern Ireland: A Study in Devolution* (Allen 1936).

29 Richard Moss, 'Back from the Dead? The New Northern Assembly Campaign' <www.bbc.co.uk/news/uk-england-16932030> accessed 18 November 2014.

30 Although devolution allows the centre to maintain an overall 'meta-control' of the arrangement itself, allowing unilateral alterations, while federalism requires renegotiation with the constituent parts.

policy.[31] Although a clear point of debate, this arrangement can provide the centre with the powers to alter and regulate relationships with external actors, such as the EU. For the UK, the extent to which the centre maintains the ability to reconfigure the relationships with devolved units without consultation remains an open debate. Pertinent are the statements of Arden LJ in *Horvarth* where she noted that UK devolution lacks the characteristics of federalism, in particular, the retention of parliamentary sovereignty enabling Westminster (subject to constitutional conventions) to restrict or revoke powers that it has given to the devolved administrations.[32]

The political and socio-economic divergences between units can also cause tensions to arise. The form of power-sharing that results from the creation of federated or devolved states can surface substantial regional biases and much debate has centred on the political solution for accommodating such differences.[33] Prime examples in the federalism context are the differences between the US states of Louisiana and California or between the German states of Saxony and Bremen. Yet, the continued debates on the 'West Lothian question' and the significant socio-economic divergences between the UK's regions demonstrate that devolution can also lead to such tensions. Problems for national unity arise if such tensions lead to the pursuit of separation and the perception that to fulfil the requirements of self-determination total independence is necessary. The current proposals for constitutional change have done little to interrogate the choice of devolution over federalism and instead (out-dated) historical rationales have remained dominant.

Not straightforward (for Northern Ireland): options for change

Human rights reform and goodbye Good Friday

At the Conservative Party conference in October 2014 there was a clearly voiced intention to introduce changes to the UK Human Rights Act 1998 (HRA) and to the relationship with the ECHR and the associated European Court of Human Rights.[34] In particular, it was made clear that if changes to that relationship could not be successfully made, a majority Conservative government would withdraw from the ECHR. As has been noted elsewhere, this is a particularly pertinent issue for Northern Ireland. The Chief Commissioner of the Northern Ireland Human Rights Commission has addressed the prospect of change to the HRA noting that it 'is well crafted and both reflects and is embedded in our constitutional arrangements'.[35] The Good Friday Agreement places the introduction of the HRA as central to its settlement.[36] Under the settlement the UK agreed to:

31 Gleider Hernández, 'Federated Entities in International Law: Disaggregating the Federal State?' in Duncan French (ed), *Statehood and Self-Determination: Reconciling Tradition and Modernity in International Law* (CUP 2013) 491–512.

32 *R (Horvath) v Secretary of State for the Environment, Food and Rural Affairs* [2007] EWCA Civ 620, [57].

33 Vernon Bogdanor, 'The West Lothian Question' (2010) 63 Parliamentary Affairs 156.

34 See 'Protecting Human Rights in the UK' (n 10).

35 Northern Ireland Human Rights Commission, 'Chief Commissioner Responds to Human Rights Act Proposals' 3 October 2014 <www.nihrc.org/news/detail/chief-commissioner-responds-to-human-rights-act-proposals> accessed 20 March 2015. The national human rights institution has also expressed concerns about the proposals: Equality and Human Rights Commission, 'Commission Warns against "Regressive" Change to Human Rights Laws' 20 March 2015 <www.equalityhumanrights.com/commission-warns-against-%E2%80%98regressive%E2%80%99-change-human-rights-laws> accessed 20 March 2015.

36 Aileen McHarg, 'Will Devolution Scupper Conservative Plans for a "British" Bill of Rights?', UK Human Rights Blog, 2 October 2014 <http://ukhumanrightsblog.com/2014/10/02/will-devolution-scupper-conservative-plans-for-a-british-bill-of-rights/>.

> complete incorporation into Northern Ireland law of the European Convention on Human Rights (ECHR), with direct access to the courts, and remedies for breach of the Convention, including power for the courts to overrule Assembly legislation on grounds of inconsistency.[37]

The Irish government, in return, agreed to incorporate the ECHR into its law and passed legislation to this effect.[38] Given that the Good Friday Agreement is partly a bilateral agreement between the UK and Ireland, the Conservative proposals would, if enacted, violate international law.[39] Besides legality, courtesy would require the UK to consult with Ireland about such changes, perhaps with a view to releasing Ireland from its corresponding obligations. Of course, it might be the case that, as with Scotland, Northern Ireland could introduce an order that implements the ECHR for Northern Ireland alone.[40] This solution, however, would miss the bilateralism of the Good Friday Agreement and, given the potential for suspension of Stormont, this would lead to a precarious situation for any human rights-based instrument. In either of these scenarios there would be a change to the current settlement. The Good Friday Agreement was put to a referendum in Northern Ireland and the Republic voted contemporaneously on changes to its constitutional settlement premised on the idea that the Good Friday Agreement would be fully implemented. As such, it seems democratically questionable to change its terms without consulting both constituencies again.[41]

Beyond the legal technicalities of the removal of ECHR protections for Northern Ireland, there would of course be practical differences. The emaciated version of human rights put forward in the Conservative proposals[42] would do little to further the human-rights-based purposes of the Good Friday Agreement. An express safeguarding purpose of this element of the Good Friday Agreement was to allow 'the Courts to overrule Assembly legislation on grounds of inconsistency'.[43] Notwithstanding the fact that domestic courts are not the Conservative's primary concern, this overruling power could be one of the incidental victims of the Conservative Party's reforms, which prioritise parliamentary intent and enactment over judicial intervention.[44] Further, with 'equality and human rights concerns' as the centrepiece of the Good Friday Agreement,[45] the language and principles of human rights purported to permit the desired plurality and tolerance. As such, in Northern Ireland, human rights protections are not *only* a check on governmental power, but also an informal check on the dominance of the 'other side'.

The external nuances of the UK's current constitutional soul-searching are further indicated in the potential ramifications of a Northern Irish 'border poll' to determine the 'constitutional position' of the province. While there has been much talk of a border poll

37 Belfast Agreement (n 1) 'Rights, Safeguards and Equality of Opportunity', para 2.

38 European Convention on Human Rights Act 2003; Fiona de Londras and Cliona Kelly, *European Convention on Human Rights Act: Operation, Impact and Analysis* (Roundhall/Thomson Reuters 2010).

39 UN Treaty Series, United Nations Treaty Series Cumulative Index vol 41 (2013). See also Northern Ireland Human Rights Commission (n 35).

40 Scotland Act 1998, s 100(1).

41 Peter F Trumbore, 'Public Opinion as a Domestic Constraint in International Negotiations: Two-Level Games in the Anglo-Irish Peace Process' (1998) 42 International Studies Quarterly 545.

42 See 'Protecting Human Rights in the UK' (n 10) 3.

43 Belfast Agreement (n 1) 'Rights, Safeguards and Equality of Opportunity'.

44 'Every judgement [sic] that UK law is incompatible with the Convention will be treated as advisory': see 'Protecting Human Rights in the UK' (n 10) 6.

45 Paul Mageean and Martin O'Brien, 'From the Margins to the Mainstream: Human Rights and the Good Friday Agreement' (1998–1999) 22 Fordham International Law Journal 1499, 1499.

in Northern Ireland, this has largely neglected the voice of the Republic.[46] The Good Friday Agreement mandated a right to self-determination for the people of the Republic in the following terms:

> it is for the people of the island of Ireland alone, by agreement between the two parts respectively and without external impediment, to exercise their right of self-determination on the basis of consent, freely and concurrently given, North and South, to bring about a united Ireland, if that is their wish, accepting that this right must be achieved and exercised with and subject to the agreement and consent of a majority of the people of Northern Ireland.[47]

As such, self-determination for 'North and South' would mean that even if Northern Ireland voted for a unification of Ireland, there would be no certainty of a united Ireland. The terms of the Good Friday Agreement and the right to self-determination would seem to mandate (albeit not clearly) the Irish government to hold a referendum on the matter. Further, the exact form that any unification would take would need careful consideration. A united Ireland could mean an end to the unitary governmental system in Dublin and move the country, for example, towards a federal or devolved system between Northern Ireland and other potential (provincial) sub-units on the island.[48]

It is by no means certain that a vote in the Republic on the matter of unification would bring about a majority of yes voters. The reunification of Germany in 1990 provides an interesting parallel. No vote took place when East Germany rejoined West Germany for two reasons: firstly, because the German Constitution never gave up its claim to the entire geographic area; and, secondly, it was by no means certain that the West Germans would vote to integrate their East-German neighbours. On the first point, changes to Articles 2 and 3 of the Irish Constitution, replacing the Republic's 'all-island claim of sovereignty' with a lesser conferral of citizenship rights on those living on the island, makes the constitutional point less clear. Therefore, if a government sought constitutional change, only then would a vote be mandatory.[49] However, most critically, like in West Germany, a yes vote in the Republic for unification is by no means certain.

The Good Friday Agreement requires that the exercise of self-determination is for the people of the island of Ireland alone.[50] It is not clear if this means that politicians from England, Wales and Scotland would be prohibited from engaging in the political debate leading up to a referendum. The Irish government remained studiously silent on the question of Scottish independence but it would seem unusual if the rest of the UK were to remain without comment if a vote were to happen in Northern Ireland.[51] Any such vote is likely, much like the Scottish vote, to gain some international comment. Both the Obama

46 Although it is true that there is not universal Northern Irish interest in a border poll. In particular, it is notable that of those who desired a border poll only 43.4% were women; Liam Clarke, 'Northern Ireland Says "Yes" to a Border Poll . . . but a Firm "No" to United Ireland' *Belfast Telegraph* (Belfast 29 September 2014).

47 Belfast Agreement (n 1) Article 1(ii).

48 This is not a new idea and was a central argument of the Irish Centre Party before the partition of the island: Colin Reid, 'Stephen Gwynn and the Failure of Constitutional Nationalism in Ireland, 1919–1921' (2010) 53 Historical Journal 723. This proposal has been mooted by Sinn Féin: Gerry Adams TD, 'A New Exciting Future – Uniting Ireland' 19 November 2011 <www.sinnfein.ie/contents/20204> accessed 18 November 2014.

49 Nineteenth Amendment of the Constitution Act 1998; Bryan Fanning and Fidele Mutwarasibo, 'Nationals/Non-nationals: Immigration, Citizenship and Politics in the Republic of Ireland' (2007) 30(3) Ethnic and Racial Studies 439, 446.

50 Belfast Agreement (n 1) Article 1(ii).

51 Patrick Smyth, 'Irish Seem Lost for Words on Scottish Independence' *Irish Times* (Dublin 18 July 2014).

administration[52] and José Manuel Barroso, President of the European Commission, commented on the potential of Scottish independence.[53] In particular, they were vocal on what independence might mean for the dénouement of UK power.

Self-determination?

The particular implications of the Good Friday Agreement for the nature of self-determination fit within broader trends. The 'self' in self-determination has become less clearly defined in the face of international influences. The Scottish referendum evidenced a tendency for international leaders to pay lip-service to the right of the Scots to determine their own future, while mounting substantive, and in some cases bad faith, arguments for one or other result.

Further, the economic and taxation choices of Scotland and Northern Ireland continue not only to be a matter for the 'self' but are also the subjects of international influence. This influence commonly occurs through the vehicle of both positive and negative examples. Scotland and Northern Ireland have been warned of the 'dangers' of changes to their taxation regimes, through the examples of 'tax havens' such as Jersey.[54] Likewise, those arguing in favour of a particular model of social democracy hold out (much-stereotyped) 'beacons' such as Norway, Luxembourg or Iceland.

In part, such arguments reflect the nature of modern global governance and, in part, they are reflective of the death of 'tax sovereignty'.[55] A high number of active tax havens enable widespread avoidance of tax liability,[56] and a global business environment can cause states to be outmanoeuvred by multinational corporations. As such, discussions of new constitutional settlements should consider the particular implications of such a globalised fiscal environment. Multilateralism and cooperation between (the constituent parts of) the UK and Ireland are essential if tax regimes are to be effective and efficient and are to avoid a 'race to the bottom'.

Bordering on the EU

Of further consideration is the potential of the UK leaving the EU and its impact on Northern Ireland.[57] The EU now comprises a complex web of overlapping legal entitlements and demands; these include the Charter of Fundamental Rights and the Schengen border agreement. At present, the Irish Republic and the UK are not part of the Schengen area (having secured an opt-out)[58] and as such there is little problem with the

52 'Obama Backs "Strong and United" UK' BBC News, 5 June 2014 <www.bbc.co.uk/news/uk-scotland-scotland-politics-27713327> accessed 18 November 2014.

53 'Barroso: Scots EU Bid "Difficult"' BBC News, 16 February 2014 <www.bbc.co.uk/news/uk-scotland-scotland-politics-26215963> accessed 18 November 2014.

54 '"Tax haven" Warning over SNP Plans' *Sunday Post* (Dundee 27 August 2014).

55 Special Rapporteur on Extreme Poverty and Human Rights, 'Report of the Special Rapporteur on Extreme Poverty and Human Rights, Magdalena Sepúlveda Carmona (Fiscal Policy and Human Rights)' UN Doc A/HRC/26/28 2014.

56 Ronen Palen, Richard Murphy and Christian Chavagneux, *Tax Havens: How Globalisation Really Works* (Cornell University Press 2013).

57 The Conservative Party position can be read at 'Let Britain Decide' <www.letbritaindecide.com> accessed 18 November 2014.

58 EU Treaty of Amsterdam 1997, 140–1.

open status of the Ireland–UK border.[59] Despite Liechtenstein, Iceland, Norway and Switzerland's status as non-EU countries that sit within the Schengen area,[60] there would likely be practical difficulties for a UK that was outside of the EU. Although not as calamitous a scenario as was sometimes portrayed in relation to a potential England–Scotland border,[61] should the UK leave the EU and Ireland then enter the Schengen area,[62] it would undoubtedly make the open border between the two states more problematic. In particular, with a dominant aim of UK political actors being to stop inward migration, the border could not be as porous. Whilst the Irish are (legally) not to be treated by the UK as 'foreigners' under the Ireland Act 1949, other EU citizens entitled to continue to come to Ireland may pose practical and political difficulties for the UK.[63] In addition, the entitlement of those born in Northern Ireland to dual citizenship of the UK and Ireland could cause practical problems.[64] If an individual chose to register for an Irish passport, they would be able to maintain their EU citizenship even if the UK left the EU. This would be in stark contrast to other UK passport-holders in Scotland, England or Wales who would not retain the right to free movement of people, services or capital that those born in Northern Ireland would retain.

If, following a border poll, Northern Ireland chose to join the Republic, it is highly unlikely that this would impact upon either UK or Irish membership of the EU. However, for a Northern Ireland that remained in the UK, leaving the EU would impact upon the Transatlantic Trade and Investment Agreement currently being negotiated with the USA.[65] While there is not space here to discuss the many problematic elements of this trade deal, a UK that sat outside of the EU would be unable to benefit from this preferential trade agreement. Such a scenario would leave Northern Ireland without privileged access to US markets whilst the Republic would maintain its own access as part of the EU. Leaving the EU would also put the UK in an entirely different position within the World Trade Organisation (WTO). Notwithstanding the UK's individual membership of the WTO, all of its negotiations are currently conducted as part of one EU block. Therefore, while the UK would stay as a member of the WTO, it would negotiate as a standalone state rather than as part of the world's biggest market. It is unlikely that the UK would be able to leave the EU and continue with the trade agreements concluded by the EU within the WTO. Again, as the Republic would remain part of the EU's block in the WTO, it would maintain the many and varied benefits that the EU holds due to its global economic power. Whilst the EU's negotiations cannot always be said to be fair or equitable to developing states, from a domestic perspective, they do currently provide beneficial access for Northern Ireland. In the short and medium term, the loss of direct access to these markets on a preferential basis would be (economically) problematic for Northern Ireland. In particular, Northern Ireland

59 Agreement between the Governments of the States of the Benelux Economic Union, the Federal Republic of Germany and the French Republic on the Gradual Abolition of Checks at their Common Borders (agreed 14 June 1985).

60 For discussion, see Andrés Delgado Casteleiro, 'Relations between the European Union and Switzerland: A Laboratory for EU External Relations?' in Francesco Maiani et al (eds), *European Integration without EU Membership: Models, Experiences, Perspectives* (European University Institute 2009) 108ff.

61 Ben Riley-Smith, 'Britons "Would Need Passport to Visit an Independent Scotland"' *The Telegraph* (14 March 2014).

62 Such an act by Ireland would also mean the end of the Common Travel Area with the UK that dates back to a 1923 agreement.

63 Ireland Act 1949, s 2(1).

64 Irish Nationality and Citizenship Act 2004, s 4.

65 European Commission, 'The Transatlantic Trade and Investment Partnership (TTIP): TTIP Explained' (8 May 2014).

would have to compete with global farmers without the protection of the Common Agricultural Policy or the myriad other concessions that EU farmers have negotiated for themselves as a powerful customs union within the WTO.[66]

Constitutional manoeuvring: global positioning

The proposed changes to human rights, bilateral agreements and the geographical/political makeup of the UK, all have potential to affect the UK's geopolitical power. The changes are likely to impact upon the state's soft and hard power. For example, a change in the UK's position within bodies such as the EU and WTO is likely to damage the soft power[67] – or 'power over opinion' – of the UK and lead to damage to the 'inextricably linked' hard ('military and economic') power of the country.[68] Indeed, for a clue to the external implications of a constitutionally/politically/economically changed UK, it is worth noting the political developments that unfolded contemporaneously to the Scottish independence referendum. That the UK parliamentary vote on military action in Iraq against Islamic State (Isis) was kept for the week after the Scottish referendum is perhaps indicative.[69] So substantial would the political and global security ramifications of a break-up of the UK be that embarking on a military operation simultaneously would be difficult. From a geopolitical perspective, Northern Ireland separating is unlikely to be as momentous as Scotland leaving the UK. Yet it would, in the longer term, continue the trend of giving reason to question the UK's entitlement to statuses such as a permanent seat on the UN Security Council or its voting power at the International Monetary Fund or World Bank Group if it were to continue a drift toward further break-up.[70]

Leaving the Council of Europe (a clearly contemplated option in the Conservatives' proposals) could also damage the UK's global power. Human rights form a substantial part of UK foreign policy[71] and membership of and adherence to the terms of the Council of Europe are likely to contribute to any respect or 'soft power' that the UK currently has. Similarly, the UK's international standing and its relationship with Ireland could suffer if the obligations under the Good Friday Agreement were not observed and consulted upon.

Conclusion

While wishes to 'reclaim' sovereignty often permeate these debates, whether the web of socio-economic, political and legal responsibilities and rights allows for 'reclaimed' sovereignty is highly questionable. A Northern Ireland that remains in a UK that leaves both the ECHR and the EU is unlikely, like the other devolved entities, to gain significant

66 European Commission, 'The Common Agricultural Policy after 2013' (29 August 2014).

67 Maria Gritsch, 'The Nation-state and Economic Globalization: Soft Geo-politics and Increased State Autonomy?' (2005) 12 Review of International Political Economy 1, 9. This applies *mutatis mutandis* in respect of human rights: Louise de Sousa, 'Women and Democracy', 9 March 2013, Lecture at Nottingham Annual Human Rights Conference <www.nottingham.ac.uk/hrlc/events/annualstudentconference/past-conferences/2013.aspx> accessed 18 November 2014; 'Farmer's Relief at EU Deal' *Belfast Telegraph* (Belfast 27 June 2014).

68 Jan Melissen, *Wielding Soft Power: The New Public Diplomacy* (Netherlands Institute of International Relations 2005) 2.

69 As, perhaps, is the invocation of geographical comparisons between the (then) size of the Isis caliphate and the combined size of Scotland, England and Wales: Jim Wells MP, 'Persecution of Christians in Iraq and Syria: Private Members' Business' 23 September 2014, Official Report of the Northern Ireland Assembly 97(6).

70 On this prospect, see Nigel D White, 'The UK's Membership of the UN in the Event of Scottish Independence' (2012) Nottingham Working Paper <http://eprints.nottingham.ac.uk/1957/> accessed 18 November 2014.

71 See e.g. UK Foreign and Commonwealth Office, 'Human Rights and Democracy: The 2011 Foreign and Commonwealth Office Report' (April 2012).

autonomy from this step alone. The same global forces which were so evident in the recent global financial and economic crises, and which exist presently with regard to ISIS, will still be there, and the ability to act independently of any outside influence will be just as difficult. Indeed, if further devolution takes place to allow the province to take control of its tax system, the same can be argued. Even other options – such as joining the Republic – are unlikely to bring complete freedom from global forces. The ability to shift fiscal policy or lower the corporate tax rate remains highly dependent on what other states are doing and the state of the global economy. Whether being subject to such free market capitalist trends is good or ill is almost beside the point. Self-determination in the modern era is not synonymous with political claims of sovereignty or full political and legal authority. Rather than attempting to (re)gain 'control' by evading global forces, political actors in the UK might better achieve their aims through accepting the existence of the global environment and contesting tenets of it. Further, there is an urgent need to take account of Northern Ireland; both in terms of the historical insights it can offer, as well as the implications of proposed changes. The current inward-looking approach to constitutional reform that does not account for the myriad of implications of an exit from various bodies is unlikely to result in a strong economic or political position for the UK or its devolved units. Rather, it will lead to an (even more) fragmented country, no better protected against the buffeting of international forces and without the redeeming virtue of furthering substantive internal self-determination.