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Hon Paul CHAN Mo-po, MH, JP
Chairman, Bills Committee on Companies Bill
Legislative Council
Hong Kong SAR

*Subject: Comments on Companies Bill*

Dear Hon Chan,

Please find enclosed my comments in relation to the Companies Bill concerning the role of this law in encouraging companies to fulfil their social responsibilities. Some of these comments draw on one of my recently published articles: „Sustainable Development: What Role for the Company Law?' (2011) 8 *International & Comparative Corporate Law Journal* 76-102. For an easy reference, I am also attaching a copy of this article.

The key argument advanced in this submission is that the Bill should not only consider imposing a duty on directors to consider the interest of key stakeholders but also expand the scope of business review to include a discussion about the company's policies and performances in relation to human rights and labour rights. This will be consistent with international trends.

I hope that the Bills Committee on Companies Bill will find these comments useful.

Should the Committee require any further information, please do not hesitate to contact me.

Yours sincerely,

Surya Deva

01.04.2011

Enclosed:

1. Comments
2. Copy of an article published in the *International & Comparative Corporate Law Journal*

## Background

1. This submission comments on one aspect of the Companies Bill, that is, the role of corporate law in encouraging companies to fulfil their social responsibilities. Companies all over the world are not only expected by their stakeholders but also increasingly required by law to respect human/labour rights and not cause the environmental pollution. In other words, companies are no longer considered only as profit-maximising entities.

2. As outlined below, there is a normative basis for corporate law to create an environment in which companies have incentives to fulfil their responsibilities towards a range of stakeholders and not merely shareholders. Recent corporate law reforms (or reform proposals) in several countries have been in this direction.

3. The Companies Ordinance Rewrite provides a valuable opportunity to make necessary revisions to learn from developments that have taken place elsewhere and to ensure that Hong Kong remains an international business and financial centre.[1] The Companies Bill (Bill) takes a modest step by proposing that the business review of a directors' report must include (i) a discussion on „the company's environmental policies and performance' and (ii) an account of the company's key relationship with those stakeholders „that have a significant impact on the company and on the which the company's success depends'.[2]

4. However, this proposal is very narrow in scope and falls short of achieving fully some of the stated objectives of the rewrite exercise. It does not, for example, require directors of a company to disclose its policies and performance on human/labour rights. The proposal is also not in line with international trends that obligate (or at least do not prohibit) directors from taking into account the interests of non-shareholders.

## Corporate Law and Social Responsibilities of Business

5. The role of corporate law in ensuring that companies are able to perform their social responsibilities should be understood and stated at the outset.

6. Traditionally, company law (or corporate governance for that matter) did not generally focus on the protecting the interests of non-shareholder stakeholders.[3] However, a number of reasons have been advanced why company law should ensure that companies do not see themselves as only machines to maximise wealth at any cost. First of all, company law provides a platform to influence the corporate behaviour *from the inside* (i.e., in the process of corporate decision making). It is desirable to focus not merely on outcomes (e.g., that companies should not violate human rights or pollute the environment) but also on processes (i.e., guiding/informing decision-makers not to take decisions which might potentially abridge human rights or environmental rights). Such broadening of company

[1] This is acknowledged in official documents related to the rewrite exercise. See „Bills Committee on Companies Bill: Background Brief', LC Paper No. CB(1)1406/10-11(01), para 11; „Legislative Council Brief: Companies Bill', CBT/17/2C, paras 3-9.
[2] Companies Bill 2011 (HK), Schedule 5.
[3] There were, of course, some exceptions. For example, Hale traces the development of stakeholder statutes in the US in the 1980. Kathleen Hale, „Corporate Law and Stakeholders: Moving beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823, 829-40.

law's focus will arguably assist companies in internalising externalities, that is, negating societal costs of doing business.[4]

7. Second, the character and role of companies in society has changed significantly in recent decades. Companies are now doing almost everything that states used to do – from running hospitals and prisons to providing security. Noting the influence of companies on the social, economic and political lives of people generally and their role as public service providers, Professor Dine argues that „the structure of company law and corporate governance are not only anachronistic but in fact wholly inaccurate in their representation of the character of companies today.'[5] Consequently, we need to rethink the role and place of companies (or business generally) in the society. Company law of course has the most critical role in redefining the role of the company in society.[6]

8. Third, the uni-focal nature of the present corporate law – conceiving companies solely or primarily as profit maximising entities – is problematic, because it creates „pressures' on corporate managers to pursue the goal of profit maximisation with total disregard for the interests of stakeholders other than shareholders.[7] This legal position also allows corporate executives to justify their irresponsible business conduct on the ground that it is mandated by corporate law.[8]

9. Fourth, it is fair to argue that companies, like other rational actors, should help solve some of the social problems that their activities have contributed to.[9] If this is the case, then company law should be amended to provide adequate guidance to company directors and managers.

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[4] Beate Sjafjell, „Internalising Externalities in EU Law: Why neither Corporate Governance nor Corporate Social Responsibility Provides the Answers' (2009) 40 *George Washington International Law Review* 977, 987-1007.

[5] Janet Dine, *Companies, International Trade and Human Rights* (Cambridge: Cambridge University Press, 2005), 265. Sealy also observes:

> [A]t present our company law lacks the *conceptual* and *remedial* tools … to reflect our new perception of the company as no longer a shareholders' collective, but an enterprise in which the interests of many stakeholders have to be balanced. It has not so far found a way to give these interests a voice – not even the machinery to voice a veto, or even access to the courts to have their say.

Len Sealy, „Perception and Policy in Company Law Reform' in David Feldman & Frank Meisel, *Corporate and Commercial Law: Modern Developments* (London: Lloyd's of London Press Ltd., 1996), 11, 28 (emphasis added).

[6] Sjafjell, above n 4, 990-91. See also James McConvill & Martin Joy, „The Interaction of Directors' Duties and Sustainable Development in Australia: Setting Off on the Uncharted Road' (2003) 27 *Melbourne University Law Review* 116.

[7] Werner writes that „pressures have pushed managers to make more profits for shareholders and to minimise diversion from those profits to serve the public welfare.' Walter Werner, „Corporation Law in Search of its Future' (1981) 81 *Columbia Law Review* 1611, 1645.

[8] For example, during the time when James Hardie was castigated for showing apathy towards asbestos victims, Meredith Hellicar, the chairwoman of James Hardie Industries, observed: „The fact of the matter is we cannot wish away our legal and fiduciary duties as much as we would like to in many respects. *At the end of the day we are custodians on behalf of the shareholders. We have obligations to our shareholders. I think that perhaps that has been forgotten in all of this*. „Don't Forget Our Shareholders: James Hardie Chair', *Sydney Morning Herald* (17 August 2004), http://www.smh.com.au/articles/2004/08/17/1092508432452.html?from=storylhs (emphasis added).

[9] Rogene A Buchholz, *Rethinking Capitalism: Community and Responsibility in Business* (New York: Routledge, 2009), 19. See also Cynthia A Williams & John M Conley, „Is there an Emerging Fiduciary Duty to Consider Human Rights?' (2005) 74 *University of Cincinnati Law Review* 75, 78-81.

10. Five, whereas corporate actions as well as non-actions affect non-shareholders in many ways, such stakeholders hardly enjoy any say in how corporations are run. Company law can and should rectify this asymmetry by obligating companies to consider the interests of non-shareholder stakeholders.[10]

11. Apart from these normative reasons, the Hong Kong government should also not be oblivious of the emerging international law jurisprudence in the area of business and human rights. On 21 March 2011, the Special Representative of the United Nations' Secretary General on the issue of human rights and transnational corporations submitted to the Human Rights Council the *Guiding Principles on Business and Human Rights*.[11] The Guiding Principle No. 3 stipulates, among others, that in meeting their duty to protect against human abuse within their respective territories, states should „ensure that other laws and policies governing the creation and ongoing operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights'.

12. The Hong Kong government is, therefore, duty-bound under the Basic Law and the International Covenant on Civil and Political Rights to ensure that the Companies Ordinance enable companies to accomplish their human rights responsibilities. If the government fails to do so, it will arguably be in breach of its obligations under international law.

**International Trends**

13. It also seems that the Bill does not fully take into cognisance of international trends reflecting a deviation from the traditional role of company law. A few illustrative instances of company laws' attempt to encourage companies to do sustainable business are noted below.

14. The UK Companies Act of 2006 imposes a specific duty on company directors to have regard, among others, to „the interests of the company's employees' and „the impact of the company's operations on the community and the environment' while promoting the success of the company.[12] Section 417 further prescribes that the business review in directors' report should contain information about company's policies about environmental matters, employees, and other social and community issues.[13] This provision – which is similar to Schedule 5 of the Hong Kong's Bill – seeks „to inform shareholders of the company and help them assess how the directors have performed their duty under Section 172'.

15. In June 2006, although a Joint Committee of the Australian Parliament rejected the need for introducing a similar amendment to Australian corporate law, it concluded that the

[10] See Hale, above n 3, 825-27.
[11] Human Rights Council, *Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises*, A/HRC/17/31 (21 March 2011), <http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf>.
[12] Companies Act 2006 (UK), s 172(1).
[13] Section 417(5)(b) provides that the business review should contain information about „(i) environmental matters (including the impact of the company's business on the environment), (ii) the company's employees, and (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies.'

existing law did not constrain directors from taking into account the stakeholders' interests.[14]

16. Parallel to the developments in the UK and Australia, the People's Republic of China (PRC) amended its Companies Law in 2005. Article 5 lays down that in its operational activities, a company shall, among others, „assume social responsibility.'[15]

17. The 2007 Limited Liability Companies Law of Indonesia provides that „Companies doing business in the field of and/or in relation to natural resources must put into practice environmental and social responsibility.'[16] Furthermore, there is also a more general provision requiring that the annual reports submitted by the Board of directors should contain a report on the implementation of environmental and social responsibility.[17]

18. The South African Companies Act of 2008 reaffirms, as one of its purposes, „the concept of the company as a means of *achieving ... social benefits*'.[18] Section 72(4) further provides that the Minister „may by regulation prescribe that a company or a category of companies must have a social and ethics committee, if it is desirable in the public interest'.

19. The 2009 Indian Companies Bill proposes that companies above a certain size shall constitute a Stakeholders Relationship Committee, which „shall consider and resolve the grievances of stakeholders'.[19] Moreover, in December 2009, the Ministry of Corporate Affairs issued the Corporate Social Responsibility Voluntary Guidelines.[20] The Guidelines lay down that each business entity should formulate a corporate social responsibility (CSR) policy, which should contain provisions for care for all stakeholders, respect for human rights and the environment, and activities for social and inclusive development.[21]

20. One may also refer to the decisions of the Supreme Court of Canada in *Peoples Department Stores Inc. (Trustee of) v Wise*[22] and *BCE Inc. v 1976 Debentureholders*[23] holding that directors can take into account the interests of non-shareholders.

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[14] „The committee considers that an interpretation of the current legislation based on enlightened self-interest is the best way forward for Australian corporations. There is nothing in the current legislation which genuinely constrains directors who wish to contribute to the long term development of their corporations by taking account of the interests of stakeholders other than shareholders.' Parliament of Australia Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (Canberra: Australian Parliament, 2006), 63, and generally 43-63.

[15] PRC Companies Law, art 5.

[16] Limited Liability Companies Law of Indonesia, Sec 74(1). „Environmental and social responsibility' is defined as „company's commitment to taking part in sustainable economic development in order to improve the quality of life and environment, which will be beneficial for the Company itself, the local community and society in general.' Id, Sec 1(3).

[17] Id, Sec 66(2)(c).

[18] South African Companies Act, Sec 7(d) (emphasis added).

[19] Indian Companies Bill 2009, Sec 158(12)/(13).

[20] Ministry of Corporate Affairs, Government of India *Corporate Social Responsibility Voluntary Guidelines* (New Delhi, December 2009).

[21] Id, pp 11-12.

[22] [2004] 3 SCR 461. The Court noted: „Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders." ... [I]n determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.'

21. Several countries such as Denmark,[24] France[25] and Norway[26] now require (certain types of) companies to disclose information concerning their social responsibility in their annual reports.

22. The trend for this policy shift in company law's traditional approach is also confirmed by research done by a group of scholars, who conclude:

> Our examination of corporate law in various jurisdictions from around the world (both civil and common law) indicates that the emerging global corporate law consensus is now leaning not towards shareholder primacy but in favour of an approach to corporate decision-making that permits and, in some cases, require the considerations of environmental and social interests in addition to the financial interests of shareholders.[27]

**Lessons for Hong Kong**

23. From this brief review of international trends, it is clear that the current draft of the Hong Kong's Bill takes only a small step forward in encouraging companies to be socially responsible. In fact, it is arguable that what the Bill proposes is legally flawed. The Bill proposes to obligate directors to include in their business review a discussion on „the company's environmental policies and performance'. This provision is apparently based on Section 417 of the UK Companies Act. But unlike the UK Act, the Hong Kong Bill does not propose to impose any duty on directors to consider the impact of their business decisions on the environment. This partial borrowing from the UK is not fully informed of the exact relation between Section 172 and Section 417 of the UK Companies Act. It is also unsound because directors are expected to report/disclose on issues which they are not legally required to consider in the first place while making business decisions.

24. It is true that not all countries have adopted the same or identical approach in harnessing their corporate laws to encourage socially responsible business. At least the following four approaches are visible:

- The UK follows the „duty approach' in that its Companies Act placed a duty on directors to take into account the interests of non-shareholders. The *obligatory* nature

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For an analysis of this decision, see Michael Kerr, Richard Janda & Chip Pitts, *Corporate Social Responsibility: A Legal Analysis* (Markham: LexisNexis, 2009), 119-29.

[23] [2008] 3 SCR 560. For a critical analysis of judicial decisions on this point in Canada, see Ed Waitzer and Johnny Jaswal, „Peoples, BCE, and the Good Corporate Citizen' (2009) 47 *Osgoode Hall Law Journal* 439

[24] Danish Financial Statements Act (Act No. 647 of 15 June 2006), sec 99(a). See Press Release from the Ministry of Economic and Business Affairs, „New Law Brings Denmark in the Lead Concerning CSR' (16 December 2008) <http://www.csrgov.dk/graphics/Samfundsansvar.dk/Dokumenter/Press_Release_L5_EN.pdf>.

[25] See Boston College Centre for Corporate Citizenship, „Disclosure – France', <http://www.bcccc.net/index.cfm/fuseaction/Page.viewPage/pageId/1018>.

[26] Norwegian Accounting Act. The current reporting requirement is limited to environmental matters. See Irja Vormedal & Audun Ruud, „Sustainability Reporting in Norway: An Assessment of Performance in the Context of Legal Demands and Socio-Political Drivers' (2009) 18 *Business Strategy & the Environment* 207; Janka Jelstad & Maria Gjølberg, *Corporate Social Responsibility in Norway: An Assessment of Sustainability Reporting by Major Firms in 2003* (Report No 5/05, 2005).

[27] Kerr et al, above n 22, 115.

of this approach may be contrasted with the *permissive* approach accepted in Australia.

- South Africa and the PRC have adopted the „purpose approach', as their corporate laws make explicit the purpose of the company or prescribe that companies have certain social responsibilities.

- Another approach is to create a channel to convey stakeholders' views to the Board of directors. As the focus here is to temper the composition of the decision making body – whether by appointing stakeholders representatives as directors[28] or establishing stakeholder committees – and thus influence decision-making process, we may call this the „composition approach'. The 2009 Indian Companies Bill and the South Africa Company Law seem to follow this approach.

- Then there is the „reporting or disclosure approach', under which companies are obligated to report periodically their performance on certain issues to their stakeholders. Apart from enhancing transparency and information flow, the underlying assumption behind this model is that stakeholders could use that information to reward or punish the companies concerned.

25. It is suggested that the Hong Kong's Bill should not only consider imposing a duty on directors to consider the interest of key stakeholders but also expand the scope of business review to include a discussion about the company's policies and performances in relation to human rights and labour rights. The Bill Committee should consider the imposition of such duty on directors carefully and take a progressive step forward, despite concerns expressed by some during the consultation stage.[29] If the Committee and the Legislative Council fail to do so, the corporate law in Hong Kong would lag behind the legal position in several common law countries.

[28] For instance, employees are represented on the Supervisory Board of companies in Germany. Kerr et al, above n 22, 142-43.

[29] See „Compendium of Responses', <http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cdrc_compendium_e.pdf>, 57-60, 66-70, 72-75.

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# SUSTAINABLE DEVELOPMENT: WHAT ROLE FOR THE COMPANY LAW?

*Surya Deva**

## 1. Introduction

What is and/or ought to be the role of company law in promoting sustainable development? Company law principles, as they evolved all over the world, did not generally deal with this question. This position is not too surprising because corporations[1] were not traditionally envisaged to play any significant role in promoting sustainable development. However, in recent times, demands are made to change this status quo for a number of reasons, e.g., to influence corporate culture, or to dispel the assumption that corporations are only profit maximising entities. Although some jurisdictions have already responded to these demands by introducing some changes in their company law frameworks, the status quo continues in most jurisdictions.

This article seeks to examine two aspects of this status quo. First, should company law encourage or mandate companies to do business in a socially responsible manner? In particular, should directors of a corporation be under any legal obligation to do business in a way that is consistent with the goal of sustainable development? This issue is examined with special reference to the company law provisions and practice in Hong Kong and the People's Republic of China (PRC) to see if they support the goal of establishing sustainable companies. I will also consider if the company law in Hong Kong – which is currently undergoing a comprehensive review process[2] – should follow the 'obligatory' model adopted by the UK in its Companies Act of 2006 or the 'permissive' model preferred by the Australian Parliamentary Committee in the same year,[3] when it comes to imposing duties on directors to take into account the interest of stakeholders.

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[1] The terms 'company' and 'corporation' are used interchangeably in this article.

[2] Hong Kong SAR Government, 'Companies Ordinance Rewrite', http://www.fstb.gov.hk/fsb/co_rewrite/eng/home/home.htm (20 January 2010).

[3] Parliament of Australia Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (Canberra: Australian Parliament, 2006).

Second, should a parent corporation be legally responsible for the conduct of its subsidiaries that causes harm to the project of sustainable development? Again, the article will review the position in Hong Kong and the PRC. For comparison, Australia and the UK will be taken as a reference point. Australia and the UK have been selected for comparison because these two countries in recent times have either amended or considered to amend their company laws to inject non-shareholders' interests within its fold. These two countries also significantly influence the legal developments at least in Hong Kong, if not in mainland China.

I begin in Part II of the article by analysing the intersection of sustainable development, companies and company law. I examine how traditionally company laws were not generally concerned with promoting sustainable development and how that paradigm has begun to change in recent years. In part III I look at the developments in the UK and Australia vis-a-vis the duties on company directors to take into account the interests of stakeholders while making decisions. Against the developments in these two jurisdictions, I review the position in the PRC, which substantially revised its company law in 2005,[4] and Hong Kong, where the existing company law is being comprehensively rewritten.[5] Part IV of the article deals with the issue of a parent company's liability for the conduct of its subsidiaries. Again the position in the PRC and Hong Kong is analysed with reference to a few relevant judicial decisions in the UK and Australia.

Before proceeding further, a few remarks about the term 'sustainable development' are desirable. A seminal definition of the term is the one offered by the World Commission on Environment and Development in its 1987 report, *Our Common Future* (commonly known as the *Brundtland Report*): 'Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.'[6] This definition highlights two key components: the satisfaction of basic or essential needs, and the limitations on the ability to meet such needs.[7]

Of course, states and the global community are expected to play an important role in fulfilling basic needs in a sustainable way. But what do these two components mean for companies? Considering that companies are key engines of development and what they do (or do not do) have a

[4] The Companies Law of the People's Republic of China, revised and adopted at the 18th Meeting of the Standing Committee of the 10th National People's Congress of the People's Republic of China on 27 October 2005. The Law came into force on 1 January 2006.
[5] Above n 2.
[6] World Commission on Environment and Development, *Our Common Future*, UN GA Res A/42/427 (1987), http://www.un-documents.net/ocf-02.htm#IV (2 May 2010).
[7] See Marie-Claire C Segger & Ashfaq Khalfan, *Sustainable Development Law: Principles, Practices and Prospects* (Oxford: OUP, 2004), 2-3.

direct bearing on the realisation of basic needs,[8] they should have certain responsibilities towards the goal of sustainable development. Therefore, for the purpose of this article, the term 'sustainable development' is construed in terms of responsibilities of companies.[9] One way to identify corporate responsibilities in this area could be looking through the lenses of human rights and environmental law,[10] for both these are integral to the concept of sustainable development. So it is posited here that as part of the sustainable development agenda, companies should have a responsibility to respect and promote human/labour rights and the environment and that this responsibility should be considered while doing business and making business decisions.[11]

## 2. Sustainable Development, Companies, and Company Law

The idea of sustainable development is not new, though there might still be disagreements on what this actually means in practice, how this could be achieved, or if it has a legally binding character.[12] However, conceptualising and operationalising the role of companies in this project is a more recent phenomenon. This issue raises several complex questions such as the following:

1) Should companies be expected or required to contribute towards the goal of sustainable development?[13]

2) If yes, what should be the nature and scope of their responsibilities?[14]

[8] See generally Surya Deva 'The *Sangam* of Foreign Investment, Multinational Corporations and Human Rights: An Indian Perspective for a Developing Asia' [2004] *Singapore Journal of Legal Studies* 305.

[9] 'A key contribution of stakeholder thinking to environmentalism and sustainability is the way it assigns responsibilities to firms.' Tara J Radin, 'Stakeholders and Sustainability: An Argument for Responsible Corporate Decision-making' (2007) 31 *William & Mary Environmental Law & Policy Review* 363, 401.

[10] It is possible to employ alternative frameworks as well. For instance, the 'triple bottom line' encompasses the idea of sustainable development. Jacqueline Cramer, *Corporate Social Responsibility and Globalisation: An Action Plan for Business* (Sheffield: Greenleaf Publishing, 2006), 14-15.

[11] 'Sustainability – the ability to sustain a high quality of life for current and future generations – requires companies *to rethink what they produce and how they do so*.' Michael Blowfield & Alan Murray, *Corporate Responsibility: A Critical Introduction* (Oxford: OUP, 2008), 27 (emphasis added).

[12] Ananda Das Gupta, *Corporate Citizenship: Perspectives in the New Century* (Cambridge Scholars Publishing, 2008), 102-03. See also Segger & Ashfaq Khalfan, above n 7, 15-50.

[13] See generally Blowfield & Murray, above n 11, 230-47.

[14] It is suffice to say here that my conception of corporate responsibilities is wider than the one proposed by Professor John Ruggie. Report of the Special Representative of the Secretary General on the issue of Human Rights and Transnational Corporations and Other Business Enterprises (SRSG), *Protect, Respect and Remedy: A Framework for Business and Human Rights* , A/HRC/8/5 (7 April 2008); Report of the SRSG, *Business and Human Rights: Towards Operationalising the "Protect, Respect and Remedy" Framework*, A/HRC/11/13 (22 April 2009) (hereinafter SRSG, 'The 2009 Report').

3) Does company law have any role to play in encouraging or ensuring that companies conduct their business in a sustainable way?

4) Should directors be duty-bound to take into account the interests of non-shareholders?

5) How to increase the participation of stakeholders in corporate decision making bodies and to secure the flow of information between corporations and their stakeholders?[15]

6) What (dis)incentives could be put in place to enhance companies' engagement with sustainable development?

7) Is there a business case for sustainable development?

8) Should companies be legally mandated to comply with sustainability reporting requirements?

9) Is any modification of existing legal principles needed to ensure that corporate executives, who take actual decisions, and not merely their corporate aggregates, are held accountable for breaching human/labour rights or polluting the environment?[16]

10) Should a parent corporation be accountable for the conduct of its subsidiaries that causes harm to the project of sustainable development?

Although all these questions deserve a detailed exploration, this article focuses only on three questions pertaining to company law. Apart from space limitations, this is done with a view to reflect on recent demands for a reorientation of the company law and its principles. I begin in this part by looking at the third question: the role that company law has played in the past and could/should play in future in at least encouraging (if not ensuring) companies to do business in a sustainable manner. The fourth question related to the scope of directors' duties is dealt with in Part III. Finally, Part IV of this article examines the last question, that is, should a

[15] Weir and Oakland argue that '[w]here a few executives from a handful of multinational corporations and their government allies are allowed to make decisions affecting entire peoples, "business as usual" will not serve the majority.' David Weir & Mark Schapiro Oakland, *Circle of Poison: Pesticides and People in a Hungry World*, (Oakland: Institute for Food and Development Policy, 1981), 69.

[16] Donaldson identifies this defect in the law as follows: 'The legal machinery is often designed to punish the agent who performs the illegal act, which in this case means the *corporation*. It is the corporation which is fined, not the corporate executives who make the decisions.' Thomas Donaldson, *Corporations and Morality* (Englewood Cliffs, New Jersey: Prentice-Hall Inc., 1982), 163 (emphasis in original). See also Brent Fisse & John Braithwaite, *Corporations, Crime and Accountability* (Cambridge: Cambridge University Press, 1993), 8-14.

parent corporation be liable for unsustainable business behaviour of its subsidiaries.

### a. Traditional Landscape: Isolated Islands

Traditionally, companies and sustainable development did not share a common landscape. Even the laws and governing institutions evolved as two distinct islands. So, human/labour rights and the environment were not the subject matter of company laws. Similarly, the laws and legal institutions dealing with human/labour rights and the environment did not conceive too much role for companies. For instance, neither the Universal Declaration of Human Rights,[17] nor the United Nations Conference on the Human Environment (Stockholm Conference)[18] made any direct reference to the responsibilities of business entities towards human rights or sustainable development.

This isolationism has been part of the problem, as I have argued in 2003 in the context of non-sharing of landscape between trade and human rights:

> One major reason for the lack of any effective regime of corporate responsibility for human rights violations is the structural lacuna in the approach adopted by concerned institutions and relevant laws. There is no sharing of a landscape between the trade institutions and the human rights institutions, or the trade law and the human rights law, both at the municipal and international levels. Broadly speaking, human rights are not a part of corporation or trade law, nor of the institutions governing them. Similarly, corporations and trade are not part of the human rights law and its institutions. … The resultant divorce of the concerns of trade and human rights at all stages of decision-making – the framing of rules, application of rules, and adjudication of disputes – brings nothing but unnecessary friction and potential conflict, promoting the interests of neither trade nor human rights.[19]

[17] General Assembly Resolution 217A (III) (10 December 1948), UN Doc. A/810 (1948). This is the position despite the oft-quoted contrary argument made by Professor Henkin: '*Every individual* include juridical persons. *Every individual and every organ of society* excludes no one, no company, no market, no cyberspace. The Universal Declaration applies to them all.' Louis Henkin, 'Universal Declaration at 50 and the Challenge of Global Markets' (1999) 25 *Brooklyn Journal of International Law* 17, 25 (emphasis in original).

[18] 5-16 June 1972, available at http://www.un-documents.net/unchedec.htm (20 January 2010).

[19] Surya Deva, 'Human Rights Violations by Multinational Corporations and International Law: Where from Here?' (2003) 19 *Connecticut Journal of International Law* 1, 32-33 [footnotes omitted]. More specifically, I wrote in 2004: 'by and large there is no sharing of landscape between the corporation law and the human rights law: human rights do not figure in law relating to corporations and vice versa.' Surya Deva, 'Corporate Code of Conduct Bill 2000:

It should be noted that this isolationism though started changing a little bit in the mid-1970s with the adoption of the OECD Guidelines for Multinational Enterprises in 1976,[20] and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises in 1977.[21] Both these instruments contemplated, in their own ways, a role for (multinational) companies in contributing to the goal of sustainable development. The OECD Guidelines, for example, expressly mentioned that companies give due consideration to 'the protection of the environment'.[22] Similarly, the 1977 ILO Declaration expected companies to 'increase employment opportunities' and 'maintain the highest standards of safety and health.'[23]

The 1990 Draft Code of Conduct on Transnational Corporations – though remained a draft due to various disagreements between developed and developing countries[24] – further buttressed the responsibilities of companies.[25] The Draft Code not only contained provisions relating to the protection of human rights and the environment[26] but also requested companies to adhere to economic goals and socio-economic objectives of the countries in which they operated.[27]

Following this trend, Chapter 30 of the Agenda 21 focused exclusively on the role of business and industry in the sustainable development project,[28] though the Rio Declaration did not explicitly refer to corporate responsibilities.[29] The establishment of the World Business Council for

Overcoming Hurdles in Enforcing Human Rights Obligations against Overseas Corporate Hands of Local Corporations' (2004) 8 *Newcastle Law Review* 87, 110-11 (hereinafter Deva, 'Overcoming Hurdles').

[20] OECD Declaration on International Investment and Multinational Enterprises, 21 June 1976, reprinted in 15 *ILM* 967 (1976). The Guidelines were significantly revised in 2000. OECD Declaration on International Investment and Multinational Enterprises 2000, reprinted in 40 *ILM* 237 (2001).

[21] Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, ILO, 204th Sess., 16 November 1977, reprinted in 17 *ILM* 422 (1978). The 1977 declaration was revised in 2000. ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy 2000, reprinted in 41 *ILM* 186 (2002).

[22] OECD Guidelines of 1976, above n 20, 972 (para 2).

[23] ILO Declaration of 1977, above n 21, 425 (para 16) and 427 (para 37), respectively.

[24] Peter Muchlinski, *Multinational Enterprises and the Law*, (updated ed., 1999), 593-97.

[25] Draft Code on Transnational Corporations in UNCTC, *Transnational Corporations, Services and the Uruguay Round*, 231 Annex IV, 234, ¶14 (1990).

[26] Id., paras 14 and 41-43, respectively.

[27] Id., paras 10 and 13.

[28] 'Strengthening the Role of Business and Industry', http://www.un-documents.net/a21-30.htm (2 May 2010). It is worth recalling that Chapter 8 of the *Brundtland Report* had also dealt with industry-related aspects of sustainable development. Above n 6, http://www.un-documents.net/ocf-08.htm (2 May 2010).

[29] A/CONF.151/26 (Vol. I) (12 August 1992). One may argue though that states could/should use the Rio principles to reach corporate behaviour. Principle 14, for instance, provides: 'States should effectively cooperate to discourage or prevent the relocation and transfer to other States of any activities and substances that cause severe environmental degradation or are found to be harmful to human health.'

Sustainable Development in 1995,[30] the launch of the UN Global Compact in 2000, and the 2002 World Summit on Sustainable Development further mapped the societal expectations from business in the area of sustainable development.[31]

Despite these above developments, company law did not deviate much from its traditional role.[32] Until recent years, company law continued to neglect the normative and practical desirability of incorporating sustainable development issues within its ambit. I argue that company law should take cognizance of the sustainable development agenda for at least five reasons. First, unless company law encourages or requires companies to do business in a sustainable way, we cannot bring changes in the corporate behaviour *from the inside* (i.e., in the process of corporate decision making). It is desirable to focus not merely on outcomes (e.g., that companies should not violate human rights or pollute the environment) but also on processes (i.e., guiding/informing decision-makers not to take decisions which might potentially abridge human rights or environmental rights).[33] Such broadening of company law's focus will also arguably help companies in internalising externalities, that is, negating societal costs of doing business.[34]

Second, some changes in company laws are required because the premises on which fundamental principles of the company law 'of all economically advanced countries'[35] were based have changed drastically.[36] Furthermore,

[30] 'About the WBCSD', http://www.wbcsd.org/templates/TemplateWBCSD2/layout.asp?type=p&MenuId=NDEx&doOpen=1&ClickMenu=LeftMenu (20 January 2010).

[31] 'One of the contrasts between the 1992 Earth Summit and WSSD was the greater participation of the private sector in forging partnerships and influencing policy. This reflects the recognition among governments and multilateral institutions, as well as by business itself, that the private sector has a crucial role to play in sustainable development.' See http://www.unep.org/resources/business/More.asp (20 January 2010). See also Ilias Bantekas, 'Corporate Social Responsibility in International Law' (2004) 22 *Boston University International Law Journal* 309, 313-14.

[32] There were, of course, some exceptions. For example, Hale traces the development of stakeholder statutes in the US in the 1980. Kathleen Hale, 'Corporate Law and Stakeholders: Moving beyond Stakeholder Statutes' (2003) 45 *Arizona Law Review* 823, 829-40.

[33] 'Corporate law directly shapes what companies do and how they do it.' SRSG, 'The 2009 Report', above n 14, para 24.

[34] Beate Sjafjell, 'Internalising Externalities in EU Law: Why neither Corporate Governance nor Corporate Social Responsibility Provides the Answers' (2009) 40 *George Washington International Law Review* 977, 987-1007.

[35] Paul Davies, *Gower and Davies's Principles of Modern Company Law*, 7th edn. (London: Sweet & Maxwell, 2003), 176.

[36] For example, the twin principles of separate personality and limited liability were extended to govern the relation of parent and subsidiary corporations of a corporate group on the assumption that since they are applicable to ordinary shareholders, they should also apply the same parity to situations when the shareholder is a corporation. This extension presents an anomalous situation because, as Blumberg argues, it makes no distinction between *corporations as investors* and *investors simpliciter*. Phillip Blumberg, 'Asserting Human Rights against Multinational Corporations under United States Law: Conceptual and Procedural Problems' (2002) 50 *American Journal of Comparative Law* 493, 494-95 (Suppl.) See also Peter T

the character and role of companies in society has changed significantly in recent decades: companies are now doing almost everything that states used to do. Noting the influence of corporations on the social, economic and political lives of people generally and their role as public service providers, Professor Dine argues that 'the structure of company law and corporate governance are not only anachronistic but in fact wholly inaccurate in their representation of the character of companies today.'[37] Consequently, we need to rethink the role and place of companies (or business generally) in the society.[38] Company law will of course have a vital role in redefining the role of the company in society.[39] McConvill and Joy argue: 'A company is a statutory creation, and therefore the legislature is entitled to determine how a company is to function and operate. … there is no justifiable conceptual or pragmatic reason why the achievement of sustainable development cannot be positioned alongside profit maximisation as the primary objective of the company.'[40]

Third, the uni-focal nature of the present corporate law – conceiving companies solely or primarily as profit maximising entities – is problematic[41] and should be altered so as not to hinder the imposition of sustainable development responsibilities on corporations.[42] In other words, law should remove the 'pressures' that company law creates on corporate managers to pursue the goal of profit maximisation with total

Muchlinski, 'Holding Multinationals to Account: Recent Developments in English Litigation and the Company Law Review' (2002) 23:6 *Company Lawyer* 168, 177; Robert B Thompson, 'Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise' (1994) 47 *Vanderbilt Law Review* 1, 35-9.

[37] Janet Dine, *Companies, International Trade and Human Rights* (Cambridge: Cambridge University Press, 2005), 265. Sealy also observes:

> [A]t present our company law lacks the *conceptual* and *remedial* tools … to reflect our new perception of the company as no longer a shareholders' collective, but an enterprise in which the interests of many stakeholders have to be balanced. It has not so far found a way to give these interests a voice – not even the machinery to voice a veto, or even access to the courts to have their say.

Len Sealy, 'Perception and Policy in Company Law Reform' in David Feldman & Frank Meisel, *Corporate and Commercial Law: Modern Developments* (London: Lloyd's of London Press Ltd., 1996), 11, 28 (emphasis added).

[38] For one such idea, see Muhammad Yunus, *Creating a World without Poverty: Social Business and the Future of Capitalism* (New York: Public Affairs, 2007).

[39] Sjafjell, above n 34, 990-91.

[40] James McConvill & Martin Joy, 'The Interaction of Directors' Duties and Sustainable Development in Australia: Setting Off on the Uncharted Road' (2003) 27 *Melbourne University Law Review* 116, 137.

[41] Redmond writes: 'Corporate law does not explicitly address the problem of corporate compliance with human rights standards; indeed, its systemic orientation aggravates the problem of standard setting and compliance … Human rights concerns are, for the most part, extraneous to corporate regulation, culture, and doctrines.' Paul Redmond, 'Transnational Enterprise and Human Rights: Options for Standard Setting and Compliance' (2003) 37 *International Lawyer* 69, 73, and generally 73-75.

[42] Donaldson, above n 16, 163-64. But see Ian B Lee, 'Is There a Cure for Corporate "Psychopathy"?' (2005) 42 *American Business Law Journal* 65 (arguing against any such need).

disregard for the interests of stakeholders[43] other than shareholders.[44] This would also nullify any attempt made by corporate executives to justify irresponsible conduct on the ground that it is mandated by corporate law.[45]

Fourth, it is increasingly conceded *now*, even by companies as well as their directors and managers, that companies are more than just economic institutions programmed to maximise shareholders' wealth.[46] The expectation is that companies should help solve some of the social problems that their activities have contributed to.[47] If this is the case, then company law should be amended to reflect this changed reality to bridge the gap between what companies *are doing* and what they *ought to be doing*. By doing so, company law will provide adequate guidance to company directors and managers.[48]

Five, whereas corporate actions and non-actions affect non-shareholders in many ways, such stakeholders hardly enjoy any say in how corporations are run. Company law can and should rectify this asymmetry by obligating companies to consider the interests of non-shareholder stakeholders.[49]

[43] It is possible to conceptualise the term 'stakeholders' encompassing both non-humans and future generations. Andrew L Friedman & Samantha Miles, *Stakeholders: Theory and Practice* (Oxford: Oxford University Press, 2006), 13-14.

[44] Werner writes that 'pressures have pushed managers to make more profits for shareholders and to minimise diversion from those profits to serve the public welfare.' Walter Werner, 'Corporation Law in Search of its Future' (1981) 81 *Columbia Law Review* 1611, 1645. Fogarty, however, observed that even if the British company law formally required directors to act in the interests of shareholders alone', in 'practice this is usually only a formal limitation'. Michael Fogarty, *Company and Corporation – One Law?* (London: Geoffrey Chapman, 1965), 7.

[45] For example, during the time when James Hardie was castigated for showing apathy towards asbestos victims, Meredith Hellicar, the chairwoman of James Hardie Industries, observed: 'The fact of the matter is we cannot wish away our legal and fiduciary duties as much as we would like to in many respects. *At the end of the day we are custodians on behalf of the shareholders. We have obligations to our shareholders. I think that perhaps that has been forgotten in all of this*. 'Don't Forget Our Shareholders: James Hardie Chair', *Sydney Morning Herald* (17 August 2004), http://www.smh.com.au/articles/2004/08/17/1092508432452.html?from=storylhs (20 January 2010) (emphasis added).

[46] A clear departure from the position taken by Milton Friedman. Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits', *The New York Times Magazine* (13 September 1970), 33; Milton Friedman, *Capitalism and Freedom*, 40th anniversary edition (Chicago: University of Chicago Press, 2002), 133-36.

[47] Rogene A Buchholz, *Rethinking Capitalism: Community and Responsibility in Business* (New York: Routledge, 2009), 19. See also Cynthia A Williams & John M Conley, 'Is there an Emerging Fiduciary Duty to Consider Human Rights?' (2005) 74 *University of Cincinnati Law Review* 75, 78-81.

[48] Radin, for instance, writes that current US corporate laws do not provide such guidance now. Radin, above n, 363-64.

[49] See Hale, above n 32, 825-27.

### b. Winds of Change: Towards Integration

The five reasons outlined above perhaps explain why, consistent with the current trend of in other areas, one may notice, in recent years, winds of change in the role of company law too. Company law is now being seen as more than an instrument to regulate relations amongst various company constituents and shareholders. The move to acknowledge and locate the interests of stakeholders within company law provisions is a step in the right direction in that this would at least explicitly bring stakeholders' interests to the board rooms. This will also promote what Kerr et al term as 'integrated decision making' by companies.[50]

It should be understood at the outset that such integration is neither a panacea nor an end in itself. Moreover, the plea of bringing sustainable development issues into the realm of company law does not mean dislocating or transferring such issues from other branches of law like environmental law and human rights law. The plea for introducing sustainable development issues into company law (i.e., internal regulation) is advanced only as complementary to external regulation of corporate behaviour.

The pleas of integrating social responsibility considerations with company law have gained momentum since the enactment of the UK's Companies Act in 2006 and the submission of the 2009 Report by Professor John Ruggie, the UN Secretary General's Special Representative on Business and Human Rights.[51] Arguments for this integration to change the corporate culture were made earlier as well.[52]

A few illustrative instances of company laws' attempt to encourage companies to do sustainable business are noted below:[53]

- The **UK** Companies Act of 2006 imposed a specific duty on company directors to have regard, among others, to 'the impact of the company's operations on the community and the environment' while promoting the success of the company.[54] This provision is analysed in more detail below.
- In June 2006, although a Joint Committee of the **Australian** Parliament rejected the need for introducing a similar amendment to Australian corporate law, it concluded that the existing law did

[50] Michael Kerr, Richard Janda & Chip Pitts, *Corporate Social Responsibility: A Legal Analysis* (Markham: LexisNexis, 2009), 106-09.
[51] SRSG, 'The 2009 Report', above n 33, paras 24-27.
[52] See, e.g., Deva, 'Overcoming Hurdles', above n 19, 110-11.
[53] Apart from these statutory illustrations, one may also refer to judicial decisions confirming this trend, e. g., the judgment of the Supreme Court of Canada in *Peoples Department Store Inc. v Wise* [2004] 3 SCR 461. For an analysis of this decision, see Kerr et al, above n 50, 119-29.
[54] Companies Act 2006 (UK), s 172(1).

not constrain directors from taking into account the stakeholders' interests.[55]

- Parallel to the developments in the UK and Australia, the **PRC** amended its Companies Law in 2005. Article 5 lays down that in its operational activities, a company shall, among others, 'assume social responsibility.'[56]
- The 2007 Limited Liability Companies Law of **Indonesia** provides that 'Companies doing business in the field of and/or in relation to natural resources must put into practice environmental and social responsibility.'[57] Furthermore, there is also a more general provision requiring that the annual reports submitted by the Board of directors should contain a report on the implementation of environmental and social responsibility.[58]
- The **South African** Companies Act of 2008 reaffirms, as one of its purposes 'the concept of the company as a means of *achieving … social benefits*'.[59] Section 72(4) further provides that the Minister 'may by regulation prescribe that a company or a category of companies must have a social and ethics committee, if it is desirable in the public interest'.
- The 2009 **Indian** Companies Bill proposes that companies above a certain size shall constitute a Stakeholders Relationship Committee, which 'shall consider and resolve the grievances of stakeholders'.[60] More recently, the Ministry of Corporate Affairs has issued the Corporate Social Responsibility Voluntary Guidelines in December 2009.[61] The Guidelines lay down that each business entity should formulate a corporate social responsibility (CSR) policy, which should contain provisions for care for all stakeholders, respect for human rights and the environment, and activities for social and inclusive development.[62]

[55] 'The committee considers that an interpretation of the current legislation based on enlightened self-interest is the best way forward for Australian corporations. There is nothing in the current legislation which genuinely constrains directors who wish to contribute to the long term development of their corporations by taking account of the interests of stakeholders other than shareholders.' Australian Report, above n 3, 63, and generally 43-63. This position is consistent with analysis made by scholars as well. Williams & Conley, above n 47, 75-77.

[56] PRC Companies Law, art 5.

[57] Limited Liability Companies Law of Indonesia, Sec 74(1). 'Environmental and social responsibility' is defined as 'company's commitment to taking part in sustainable economic development in order to improve the quality of life and environment, which will be beneficial for the Company itself, the local community and society in general.' Id, Sec 1(3).

[58] Id, Sec 66(2)(c).

[59] South African Companies Act, Sec 7(d) (emphasis added).

[60] Indian Companies Bill 2009, Sec 158(12)/(13).

[61] Ministry of Corporate Affairs, Government of India *Corporate Social Responsibility Voluntary Guidelines* (New Delhi, December 2009).

[62] Id, pp 11-12.

- In addition, several countries such as Denmark,[63] France[64] and Norway[65] require (certain types of) companies to disclose CSR information in their annual reports. Many stock exchanges have also introduced CSR indices or CSR disclosure requirements.[66] Last but not least, proposals such as the Code for Corporate Citizenship have made pleas to amend corporate laws in the US states.[67]

The trend for this policy shift in company law is also confirmed by research done by a group of scholars, who conclude:

> Our examination of corporate law in various jurisdictions from around the world (both civil and common law) indicates that the emerging global corporate law consensus is now leaning not towards shareholder primacy but in favour of an approach to corporate decision-making that permits and, in some cases, require the considerations of environmental and social interests in addition to the financial interests of shareholders. [68]

But not all countries have adopted the same or identical model. Different company laws have embraced different models. At least four of these are in operation now. First is the 'duty model' adopted by the UK and

[63] Danish Financial Statements Act (Act No. 647 of 15 June 2006), sec 99(a). See Press Release from the Ministry of Economic and Business Affairs, 'New Law Brings Denmark in the Lead Concerning CSR' (16 December 2008) http://www.csrgov.dk/graphics/Samfundsansvar.dk/Dokumenter/Press_Release_L5_EN.pdf (20 August 2010).

[64] See Boston College Centre for Corporate Citizenship, 'Disclosure – France', http://www.bcccc.net/index.cfm/fuseaction/Page.viewPage/pageId/1018 (20 August 2010).

[65] Norwegian Accounting Act. The current reporting requirement is limited to environmental matters. See Irja Vormedal & Audun Ruud, 'Sustainability Reporting in Norway: An Assessment of Performance in the Context of Legal Demands and Socio-Political Drivers' (2009) 18 *Business Strategy & the Environment* 207; Janka Jelstad & Maria Gjølberg, *Corporate Social Responsibility in Norway: An Assessment of Sustainability Reporting by Major Firms in 2003* (Report No 5/05, 2005).

[66] See 'Taking Stock: How Leading Stock Exchanges are Addressing ESG Issues and the Role they can Play in Enhancing ESG Disclosure', http://www.eiris.org/files/research%20publications/StockExchanges&ESGNov09.pdf (20 August 2010).

[67] Robert Hinkley, '28 Words to Redefine Corporate Duties', http://corporatecode.org/docs/28_words_to_change.pdf (20 January 2010).

[68] Kerr et al, above n 50, 115. Radin also argues:

> Although corporate law has traditionally emphasised stockholder primacy, current thinking about the law and the role of business in society emphasises attention to stakeholder considerations. Moreover, present American law (specifically, the business judgment rule) not only grants managers considerable discretion as to the sources that they may consider to influence their decision-making, today's so-called "corporate law" (and "law" more generally conceived) is replete with stakeholder-specific legislation that prioritises various interests and concerns over profit generation. Reframing our understanding of the firm in accordance with a stakeholder-based relationship view is therefore consistent with both underlying legal principles and societal interests.
>
> Radin, above n 9, 368 (footnotes omitted).

Australia in that it placed a duty on directors to take into account the interests of non-shareholders. Within this model, the UK and Australia signify two contrasting approaches: the *obligatory* approach adopted by the UK law and the *permissive* approach accepted by Australia. This distinction is highlighted in the next part.

The second model could be termed as the 'purpose model'. Instead of imposing duties on directors, the aim is to make explicit the purpose of the company or prescribe that company has certain social responsibilities. The company laws of South Africa and the PRC illustrate this model. The expectation of course is that directors and managers of the company will act within the board parameters of the specified objective.

The third model seeks to create a channel to convey stakeholders' views to the Board. As the focus here is to temper the composition of the decision making body – whether by appointing stakeholders' representatives as directors[69] or establishing stakeholder committees – and thus influence decision-making process, we may call this the 'composition model'. The 2009 Indian Companies Bill and the South Africa Company Law seem to follow this model.

The fourth model is the 'reporting or disclosure model', under which companies are obligated to report periodically their performance on certain issues to their stakeholders. Apart from enhancing transparency and information flow, the underlying assumption behind this model is that stakeholders could use that information to reward or punish the companies concerned.

It should be clear from the brief review of the company law trends in various countries that features of more than one model could be combined for better efficacy. For example, the South African Company Law has adopted both *purpose* and *composition* models.[70]

### 3. Directors' Duties to Stakeholders

In this part, I specifically look at the need (and possible trend) for imposing duties on company directors to take into account the interests of stakeholders. Various reasons may be advanced for imposing on directors such duties.[71] I will allude here to only two rationales. First, since directors are crucial to what a company does and how,[72] the scope of their duties

[69] For instance, employees are represented on the Supervisory Board of companies in Germany. Kerr et al, above n 50, 142-43.
[70] South African Companies Act, Sec 7(d) and Sec 72(4).
[71] See, e.g., Peter Waring, 'Rethinking Directors Duties in Changing Global Markets' (2008) 8:2 *Corporate Governance* 153.
[72] Kerr et al, above n 50, 110-11.

should not be limited to shareholders. Otherwise, non-shareholders will lack a basis to push for the recognition of their interests in the decision-making process.

Second, the absence of duties on directors to consider stakeholders' interests contributes to the externalisation of their interests resulting in negative societal consequences. Scalise writes: 'It is the limited duty of corporate directors that creates an environment where a corporate decision may cause harm and allows the harmful conduct to go unpunished. Since directors only owe a legal duty to shareholders, directors may regard external interests as irrelevant in their decision making.'[73] Even in the absence of such a specific duty, directors may/do take into account the interests of non-shareholders, but that is discretionary and usually driven by a desire to promote or protect shareholders' interests.

### c. Perspectives from the UK and Australia

The 2006 Companies Act of the UK imposes a specific-explicit duty on company directors to take into account the interests of a range of stakeholders in the process of promoting the success of the company. Section 172, which enshrines the idea of 'enlightened shareholders value'[74] and is a 'pivotal part' of the directors' duties, stipulates the following:[75]

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

[73] Elisa Scalise, 'The Code for Corporate Citizenship: States should Amend Statutes Governing Corporations and Enable Corporations to be Good Citizens' (2005) 29 *Seattle University Law Review* 275, 283.
[74] Bill Perry & Lynne Gregory, 'The European Panorama: Directors' Economic and Social Responsibilities' (2009) 20:2 *International Company & Commercial Law Review* 25, 27.
[75] Andrew Keay, 'Section 172(1) of the Companies Act 2006: An Interpretation and Assessment' (2007) 28:4 *Company Lawyer* 106, 106.

(f) the need to act fairly as between members of the company.

This provision has attracted mixed response as to its role in promoting CSR. While some scholars perceive Section 172 as merely codifying an existing common law duty,[76] others hail it as 'a considerable step forward in bringing CSR and integrated decision-making into the core duties of the directors of UK-based corporations.'[77] Although the usefulness of Section 172 is apparent, this provision might have fallen short of what company laws could and should do.[78] Some of these limitations may be noted here. First, directors might be able to satisfy the requirement of considering the Section 172 variables quite easily. As long as a director believed in good faith that something is most likely to promote the success of the company, the courts are unlikely to substitute their judgement with that of the director, even if her belief was unreasonable but honest.[79] In other words, this provision provides directors with an almost 'unfettered discretion' and provides 'no objective criteria that can be used to assess what the directors have done.'[80]

Second, and more importantly, this provision does not provide directors a clear normative guidance on how to balance the interests of the company / shareholders with stakeholders' interests.[81] For instance, having regard to the interests of company's employees does not mean that directors cannot lay off employees if that is needed to avoid liquidation. Some scholars argue that Section 172 requires directors to consider stakeholders' interests 'in the context of promoting the benefit of the members'.[82] However, if that is the case, then this provision does not go far in that the interests of employees, customers or the community would be served only if doing

[76] Gordon L Clark & Eric R W Knight, 'Implications of the UK Companies Act 2006 for Institutional Investors and the Market for Corporate Social Responsibility' (2009) 11 *University of Pennsylvania Journal of Business Law* 259, 277-78. Williams and Conley argue that 'boards' current fiduciary duties *to their shareholders* require them to consider the rights and interests of stakeholder groups, including those rights and interests exemplified in the international law of human rights.' Williams & Conley, above n 47, 77 (emphasis in original). They admit that in many instances, such requirements are not legal but market requirements. Id.

[77] Kerr et al, above n 50, 129-30.

[78] A report by the UK's Joint Parliamentary Committee concluded that the 2006 Companies Act 'could have gone much further to promote respect for human rights by UK companies.' House of Lords and House of Commons Joint Committee on Human Rights, *Any of Our Business? Human Rights the UK Private Sector* (December 2009), Vol 1, 76 (para 254). See also Keay, above n 75.

[79] Stephen W Mayson, Derek French & Christopher L Ryan, *Mayson, French & Ryan on Company Law*, 24th edn. (London: Blackstone, 2007) 455 (quoting several pre-2006 judicial decisions).

[80] Keay, above n 75, 107, and generally 106-08.

[81] '[T]here is no guidance in the Act as to the weight to be given to each factor and how conflicts between the factors [enumerated in Section 172] should be resolved.' Perry & Gregory, above n 74, 29.

[82] *Mayson, French & Ryan on Company Law*, above n 79, 459. See also Clark & Knight, above n 76, 277.

so also benefits shareholders.[83] In other words, Sections 172 is an implicit recognition of the business case for CSR. This gives rise to the question: what about those situations in which there is no (clear) business case?

Third, although the provision lists several issues as well as stakeholders, it makes no express reference to human rights. This is a significant omission considering the vast corpus of literature and litigation suggesting that companies do have human rights responsibilities.

Fourth, a crucial question is about the *locus standi* to enforce the Section 172 duties. Who could enforce these duties? Can affected non-shareholders sue directors for an alleged breach of duties? This issue is important because duties hardly mean much generally, or for corporate governance, unless there is an effective mechanism for their enforcement.[84] It is doubtful if non-shareholders could initiate a legal action for breach of Section 172.[85] One reason could be that the duty 'is owed only to the company, not to individual shareholders or to the third parties.'[86] Therefore, the efficacy of these duties would be dependent – to a large extent – on the presence of some active and morally conscious shareholders.

In short, while the explicit imposition of duties on directors in the UK might not have gone too far or might not bring a significant change in the current corporate culture, this is definitely a step in the right direction.[87] This provision may provide a basis for further incremental changes in broadening the scope of company law beyond narrow corporate governance issues.

In addition to imposing CSR duties on directors under Section 172, the UK Companies Act in Section 417 prescribes that the business review in director's report should contain information about company's policies about environmental matters, employees, and other social and community issues.[88] This provision – which seeks 'to inform shareholders

[83] Section 172 'while requiring various stakeholder interests to be considered, still treats the interests of the members as paramount.' Ji Lian Yap, 'Considering the Enlightened Shareholder Value Principle' (2010) 31:2 *Company Lawyer* 35, 36.

[84] Demetra Arsalidou, 'Litigation Culture and the New Statutory Derivative Claim' (2009) 30:7 *Company Lawyer* 205, 205.

[85] 'The only stakeholders in the company who are able to take action under the Act appear to be the shareholders.' Keay, above n 75, 109. See also Adefolake Adeyeye, 'The Limitations of Corporate Governance in the CSR Agenda' (2010) 31:4 *Company Lawyer* 114, 116.

[86] Rosemary Craig, '"The Enormous Turnip": A Discussion on the Companies Act 2006 which, like Topsy in the Child's Fairy Tale, is still Growing' (2008) 29:12 *Company Lawyer* 360, 361.

[87] See Hale, above n 32, 840-41.

[88] Section 417(5)(b) provides that the business review should contain information about '(i) environmental matters (including the impact of the company's business on the environment), (ii) the company's employees, and (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies.'

of the company and help them assess how the directors have performed their duty under Section 172' – reinforces the expectation about these CSR duties being executed and documented.[89] Section 417 might facilitate in comparing what companies preach and what they actually do on the CSR front. But again one should notice the inherent limitation: Section 417 expressly relies solely on shareholders to judge the extent to which directors of a given company have fulfilled their social responsibilities. Other stakeholders may, nevertheless, use this information to at least 'name and shame' companies and encourage some conscientious shareholders to be more socially responsive. As we will see below, Hong Kong may adopt this practice of business review in director's report in its revised company law, though without imposing CSR duties on directors.

One indirect but immediate effect of the above company law development in the UK was felt in Australia. In June 2005, a Joint Parliamentary Committee was constituted to examine, among others, 'whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community.'[90]

After hearing and noting diverse views, the Committee did not consider it necessary to follow the UK model enshrined in Section 172. The Committee concluded that 'the Corporations Act 2001 permits directors to have regard for the interests of stakeholders other than shareholders' and 'that amendment to the directors' duties provisions within the Corporations Act is not required.'[91] A further reason given was that 'any hesitation on the part of corporate Australia does not arise from legal constraints found in the Corporations Act. As the problem is not legislative in nature, the solution is unlikely to be legislative in nature.'[92] So despite rejecting the need for imposing explicit duties on directors, the Australian Committee believed that the 'enlightened self-interest' would encourage directors and companies to take into account the interests of stakeholders.

It is notable that even if the Australian Corporations Act did not prohibit directors from taking into account stakeholders' interests, it required

[89] See, for an analysis of the inter-relationship between Section 172 and Section 417, Charlotte Villiers, 'Directors' duties and the company's internal structures under the UK Companies Act 2006: obstacles for sustainable development' in this issue, especially footnotes 35-46 and surrounding text.

[90] Australian Report, above n 3, vii. James Hardie saga also contributed to the establishment of this Committee. Waring, above n 71.

[91] Australian Report, above n 3, 63. This view is also supported by commentaries on Australian company law. RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (Chatswood: LexisNexis Butterworths Australia, 2005) 281; Pamela Hanrahan, Ian Ramsay & Geof Stapledon, *Commercial Applications of Company Law* (Sydney: CCH Australia, 2006) 236.

[92] Australian Report, above n 3, 63.

'that, as a general rule, the interests of employees and other stakeholders … should not be given priority by directors over the interests of the company's members.'[93] At the same time, one should not forget that even Section 172 of the UK Companies Act does not confer an equivalent or higher status on stakeholders' interests vis-à-vis the interests of shareholders.

On comparing the UK and Australian positions, one may notice a representation of two different approaches regarding the CSR duties of directors. Whereas the UK's model could be regarded 'obligatory', the Australian model is 'permissive' in nature.[94] The former mandates directors to consider stakeholders' interests, the latter allows directors to do so if they wish.[95]

Despite not imposing any CSR duties on directors, the Australian Corporations Act provides that if a company's operations are subject to any particular and significant environmental regulation under a Commonwealth or State law, it should provide details of the company's performance in relation to environmental regulation in director's annual report.[96] This provision is comparable to Section 417 of the UK Act. But the scope of the Australian provision is narrower in that it deals with only environmental issues.

### d. The Position in Hong Kong and the PRC

The existing Companies Ordinance of Hong Kong does not codify the duties of directors. So, for obvious reasons, there are no provisions in the Ordinance that impose any specific duty on company directors to consider the interests of stakeholders or to pursue policies of sustainable business. In mid-2006, the Hong Kong government launched a comprehensive review aimed at rewriting the current Companies Ordinance.[97] This review in theory provided Hong Kong an opportunity to provide a company law framework which directors could employ to balance shareholders' interests with the interests of stakeholders. However, as we will see below, this opportunity appears to have been wasted.

In April 2008, the Second Consultation Paper sought public views, among others, on two issues:

[93] Hanrahan et al, above n 91, 236.
[94] Some commentators seem to consider even the UK's model permissive. SRSG's Corporate Law Tools Project, 'Summary Report on Expert Meeting on Corporate Law and Human Rights: Opportunities and Challenges of Using Corporate Law to Enforce Corporations to Respect Human Rights' (5-6 November 2009, Toronto), 6.
[95] See Kerr et al, above n 50, 114.
[96] Australian Corporations Act 2001, Section 299(1)(f).
[97] 'Companies Ordinance Rewrite', http://www.fstb.gov.hk/fsb/co_rewrite/eng/home/home.htm (20 January 2010).

1) whether directors' duties – which are currently found in the case law – should be codified, and

2) whether Hong Kong should follow the UK approach in requiring directors to consider other factors such as the long-term consequences of the decision, the interests of employees, and the impact of company's operation on the community and environment?[98]

The Consultation Paper makes reference to CSR only in one place, that is, under 'enhancing corporate governance' as a guiding principle to the rewrite exercise.[99] More than half of the respondents who participated in the consultation opposed the codification of general duties of directors.[100] Based on the consultation feedback, although the Committee concluded against the comprehensive codification of directors' duties, it saw 'some merit in clarifying the directors' standard of care, skill and diligence.'[101]

Out of those respondents who supported the codification of directors' duties, a great majority did not find value in following the UK approach incorporated in Section 172.[102] Reasons for opposition were varied – ranging from that CSR should be achieved via education and encouragement rather than legal requirement to lack of clarity in the notion of 'enlightened shareholder value'. So at this stage it is safe to say that the revised Companies Ordinance of Hong Kong is unlikely to impose a duty on company directors to take into account the interests of stakeholders.[103] In fact, the Committee did not even concede or contradict the conclusion reached by the Australian Parliamentary Committee that the existing company law does not preclude directors to consider stakeholders' interests.

Nevertheless, there is a proposal that offers some hope for companies' engagement with the project of sustainable development. It is proposed

[98] 'Consultation Paper', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/2ndPCCOR_e.pdf (20 January 2010), 20.

[99] 'The rewrite aims to strengthen corporate governance, taking into account the interests of stakeholders, such as members and creditors, and considering other relevant factors, such as corporate social responsibility initiatives in the company law of comparable jurisdictions.' Id., 5-6.

[100] 'Consultation Conclusions', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cdrc_conclusion_e.pdf (20 January 2010), 8-9. See also 'Compendium of Responses', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cdrc_compendium_e.pdf (20 January 2010), 55-83.

[101] 'Consultation Conclusions', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cdrc_conclusion_e.pdf (20 January 2010), 9; 'Consultation Paper – Draft Companies Bill', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/CB_Consultation_Paper_Full_e.pdf (20 January 2010), 11.

[102] 'Compendium of Responses', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/cdrc_compendium_e.pdf (20 January 2010), 57-60, 66-70, 72-75.

[103] See, for an analysis, Davy Ka Chee Wu, 'Managerial Behaviour, Company Law, and the Problem of Enlightened Shareholder Value' (2010) 31:2 *Company Lawyer* 53.

that the business review should include, among others, 'a discussion on the company's environmental policies and performance, including compliance with the relevant laws and regulations; and an account of the company's key relationships with employees, customers, suppliers and others, on which its success depends.'[104] The Committee saw the proposed requirement as being 'in line with international trends to promote corporate social responsibility'.[105] It is yet to be seen if this proposal will finally find its way into the law.

Let us now consider the company law provisions of the PRC. On 27 October 2005, China adopted a revised companies law, which came into force from 1 January 2006.[106] Although China is a civil law country, this law has been influenced by Anglo-American company laws.[107] The PRC Companies Law has codified the duties of directors,[108] but one cannot find any explicit or specific duty mandating directors to safeguard the interests of stakeholders or the community.[109]

There are, however, some general or specific provisions that indicate that companies should do business in a socially responsible manner. For example, Article 5 stipulates: 'In its operational activities, a company shall abide by laws and administrative regulations, observe social morals and commercial ethics, persist in honesty and good faith, accept supervision by the government and the public, and assume social responsibility.' This provision resonates with the continental European position where 'the corporation is foremost a social institution and is treated as such in corporate law.'[110]

One could also find some specific provisions that recognise rights of certain stakeholders such as employees. Article 17 provides that companies 'shall protect the lawful rights and interests of their staff and workers, sign labour contracts with them according to law, participate in social insurance, and improve occupational protection so as to achieve safety in production.' It further lays down that companies shall 'improve vocational education and on-the-job training among their staff and workers so as to enhance their quality.'[111]

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[104] 'Consultation Paper – Draft Companies Bill', http://www.fstb.gov.hk/fsb/co_rewrite/eng/pub-press/doc/CB_Consultation_Paper_Full_e.pdf (20 January 2010), 13.
[105] Id, 14.
[106] Above n 4.
[107] Peter Koh, *Major Issues in Company Law: With PRC Chinese and English Comparative Law Notes* (Singapore: Sweet & Maxwell, 2009), 156.
[108] PRC Companies Law, Secs 21(1), 148 and 149.
[109] However, Chinese company law scholars are not unaware of the concept of CSR. See Gu Minkang, *Understanding Chinese Company Law* (Hong Kong: Hong Kong University Press, 2006), 156.
[110] Clark & Knight, above n 76, 260-61. See also Kerr et al, above n 50, 141-45.
[111] PRC Companies Law, Art 17.

Considering that even the developed common law jurisdictions are hesitant to embrace CSR duties on company directors, it is unlikely that the PRC law will impose such duties on directors in the near future. This might create its own problems because as Chinese companies break shackles of operating in a socialist economy, they might be more prone to the pitfalls of profits maximisation in a free market environment. Some recent cases seem to support this hypothesis, e.g., sale of melamine-contaminated baby milk products, use of cadmium in toys and jewellery, harsh working conditions in factories contributing to suicides by workers, poor safety standards in coal mines resulting in death of workers, and scant respect shown by factories to the environment.[112]

## 4. Responsibility of a Parent Company for the Conduct of its Subsidiaries

Historically, companies, being artificial entities, were not allowed to hold shares in other companies; only natural persons had the privilege of holding shares in artificial entities.[113] However, the current position is much different as now the company law of almost all countries (both common law and civil law) permits companies to hold shares in other companies and do business through their subsidiaries. In fact, one could say that the two well-known corporate principles – principles of separate personality and limited liability – *encourage* companies to create and operate through subsidiaries. Among others, the encouragement arises from a legal position that entitles parent companies to reap the benefits of subsidiaries' business but at the same time insulate themselves from liability, if any.

This legal position is manifestly unjust on account of creating a disparity between risks and rewards allocated to shareholders, as pointed out by a leading authority on company law.[114] It also creates incentives for companies to do business in a socially irresponsible manner.[115] There is, for instance, some evidence to suggest that corporations might create

[112] See generally International Commission of Jurists (ICJ), *Access to Justice: Human Rights Abuses Involving Corporations – People's Republic of China* (Geneva: ICJ, 2010), 59-67.

[113] Phillip Blumberg, *The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality* (New York: Oxford University Press, 1993), 52 (hereinafter Blumberg, *The Search for a New Corporate Personality*).

[114] '[T]here is an apparent disparity in the risks and rewards which are allocated to shareholders: they benefit, through limited liability, from a cap of their down-side risk, whereas the chance of up-side gain is unlimited.' Davies, above n 35, 176.

[115] '[Limited liability] means that no matter how much environmental damage a corporation causes, no matter how much debt it defaults on, no matter how many Malibus explode or tires burst or workers and consumers die of asbestosis, no matter how many people it puts out of work without their pension benefits or other protections; in short, no matter how much pain it causes, the corporation is responsible for paying damages (if at all) only in the amount of assets it has.' Lawrence E Mitchell, *Corporate Irresponsibility: America's Newest Export* (New Haven: Yale University Press, 2001), 53.

under-funded subsidiaries to do potentially hazardous business and thus, limit their legal liability against future litigation.[116]

I argue, therefore, that if companies have a role to play in the project of sustainable development,[117] then the twin principles might have to be appropriately modified or limited. Admittedly, these principles serve important purposes,[118] yet they should not be allowed to become a standard refuge for evading liability, say, for human rights violations or environmental pollution.[119]

### e. Perspectives from the UK and Australia

At common law the UK courts have developed a number of exceptions to the principles of separate personality and limited liability.[120] However, as the decision in *Adams v Cape Industries Plc* shows,[121] it is not easy for the victims to bring the case within the purview of these exceptions. Two subsequent House of Lords decisions in *Lubbe*[122] and *Connelly*,[123] however, have tried to deal with this issue in a different manner, that is, by putting the parent company under a direct duty of care under tort law. As we will see below, a similar approach was adopted by the Australian courts around the same time.

Under Australian company law, the courts have created some exceptions to pierce the corporate veil, e.g., when the company is an agent of the shareholder, or the company is used as an instrument of fraud.[124] However, the courts have exercised their discretion only in 'rare and

[116] See Henry Hansmann & Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 *Yale Law Journal* 1879, 1891.
[117] I have argued elsewhere that companies are indispensible to achieving the agenda of sustainable development. Surya Deva, 'Sustainable Good Governance and Corporations: An Analysis of Asymmetries' (2006) 18 *Georgetown International Environmental Law Review* 707, 712-14.
[118] 'Limited liability for equity investors has long been explained as a benefit bestowed on investors by the state.' Frank H Easterbrook & Daniel R Fischel, 'Limited Liability and Corporation' (1985) 52 *University of Chicago Law Review* 89, 93, and generally 93-7. See also Blumberg, *The Search for a New Corporate Personality*, above n 113, 125-33; Ian Ramsay, 'Allocating Liability in Corporate Groups: An Australian Perspective' (1999) 13 *Connecticut Journal of International Law* 329, 341-2.
[119] [S]trong empirical evidence indicates that increasing exposure to tort liability has led to the widespread reorganisation of business firms to exploit limited liability to evade damage claims.' Hansmann & Kraakman, above n 116, 1891. See also Richard S Farmer, 'Parent Corporation Responsibility for the Environmental Liabilities of the Subsidiary: A Search for the Appropriate Standard' (1994) 19 *Iowa Journal of Corporation Law* 769.
[120] Davies, above n 35, 184-89.
[121] [1990] 2 WLR 786.
[122] [2000] 1 WLR 1545.
[123] [1997] 4 All ER 335.
[124] Elizabeth Boros & John Duns, *Corporate Law* (South Melbourne: Oxford University Press, 2007) 42-44.

extreme' cases.[125] More so, an empirical study has indicated that the courts pierce the corporate veil less frequently when piercing is sought against a parent company than when piercing is sought against one or more individual shareholders, and that courts pierce more frequently in a contract context than in a tort context.[126]

Nevertheless, it may be instructive to review the decisions in the following two cases: *Briggs v James Hardie & Co Pty Ltd*.,[127] and *CSR Limited v Wren*,[128] both of which related to the asbestos liability of a parent company in a situation where the workers were employed and exposed to asbestos by the subsidiaries. Rejecting the argument for piercing the veil on the ground of control exercised by the parent company, Justice Rogers in *Briggs* observed:

> ... as the law presently stands, in my view the proposition advanced by the plaintiff that the corporate veil may be pierced where one company exercises complete dominion and control over another is entirely too simplistic. The law pays scant regard to the commercial reality that every holding company has the potential and, more often than not, in fact does, exercise complete control over a subsidiary …[129]

In *Wren*, on the other hand, the court bypassed the veil piercing issue by directly reading a duty of care on the parent company, as it exercised a high degree of management control over its subsidiary (e.g., the whole management staff of the subsidiary were employees of the parent company).[130]

### f. The Position in Hong Kong and the PRC

Hong Kong company law recognises every company of a corporate group to be a separate entity. Like other common law jurisdictions, the courts will lift the corporate veil in exceptional circumstances, e.g., when the subsidiary is a sham or facade of the parent company.[131] The Hong Kong courts usually follow the UK cases on this issue and are not generally inclined to lift the veil, unless the company is used, for instance, as a

[125] Boros & Duns, above n 124, 41.
[126] Ian Ramsay & David Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19 *Company & Securities Law Journal* 250.
[127] [1989] 16 NSWLR 549.
[128] (1998) 44 NSWLR 463.
[129] [1989] 16 NSWLR 549, 577
[130] Sarah Joseph, *Corporations and Transnational Human Rights Litigation* (Oxford: Hart Publishing, 2004), 134-35.
[131] Vanessa Stott, *Hong Kong Company Law*, 12th edn. (Hong Kong: Longman Hong Kong Education, 2008), 12-17. See also *Lee Sow Keng Janet v Kelly Mckenzie Ltd.* [2004] HKCU 904.

cloak for a deception,[132] or conceal true facts.[133] For instance, in *China Ocean Shipping Co v Mitrans Shipping Co Ltd*,[134] the court followed *Adams v Cape Industries* and ruled that the veil could not be lifted merely because companies have used the corporate structure to avoid incurring legal obligations.[135]

The Chinese Companies Law also recognises both principles of separate personality and limited liability.[136] The Law also allows companies to invest in other enterprises, without accepting joint and several liability for the debts of the enterprises in which it invests.[137] In other words, the well-known principles of separate personality and limited liability are expressly applied to a corporate group situation. At the same time, the Companies Law, after the 2005 amendment, provides for lifting of the corporate veil on a statutory basis[138] (unlike common law jurisdictions where it is a matter of judicial discretion). Article 20 reads:

> The shareholders of a company shall comply with the laws, administrative regulations and articles of association, and shall exercise the shareholders' rights according to law. None of them may injure any of the interests of the company or of other shareholders by abusing the shareholders' rights, or injure the interests of any creditor of the company by abusing the independent status of legal person or the shareholders' limited liabilities. …
>
> Where any of the shareholders of a company evades the payment of its debts by abusing the independent status of legal person or the shareholders' limited liabilities, and thus seriously damages the interests of any creditor, it shall bear joint liabilities for the debts of the company.[139]

[132] *HKSAR v Leung Yat Ming* [1999] 2 HKC 754.
[133] *Liu Hon Ying v Hua Xin State Enterprise (HK) Ltd.* [2003] HKCU 706.
[134] [1995] 3 HKC 123.
[135] See also *Toptrans Ltd. v Delta Resources Co Inc.* [2005] HKEC 92, where despite common control, the court did not lift the veil.
[136] Article 3 reads: 'A company is an enterprise legal person, which has independent property of a legal person and enjoys the property rights of a legal person. The company shall be liable for its debts to the extent of its entire property. Shareholders of a company with limited liability shall assume liability towards the company to the extent of the capital contributions subscribed respectively by them; and the shareholders of a company limited by shares shall assume liability towards the company to the extent of the shares subscribed respectively by them.'
[137] PRC Companies Law, Article 15.
[138] Koh, above n 107, 88-92; Mark Wu, 'Piercing China's Corporate Veil: Open Questions from the Company Law' (2007) 117 *Yale Law Journal* 329; Gu, above n 109, 334.
[139] PRC Companies Law, Article 64. It further provides a special veil piercing provision related to single-shareholders companies. It reads: 'If the shareholder of a one-person limited liability company is unable to prove that the property of the one-person limited liability

This provision lists the grounds on which the corporate veil could be lifted by the courts.[140] On a plain reading, it appears that this provision could be used by the victims of corporate human rights abuses to reach a parent company with deep pockets. But in practice, there might be a problem in doing so, because the primary focus of Article 20 is seemingly to safeguard creditors' interests, say, against corporate frauds or misfeasance and insolvency.[141] It is, therefore, not clear if the courts could or would employ this provision to hold a parent company liable for human rights violations by its subsidiary. Wu argues:

> The new law explicitly discusses only the rights of creditors. Although bankruptcies are important context in which veil piercing is invoked, they are, by no means, the only ones. China's courts are bound to face demands to pierce the corporate veil in non-creditor situations in the coming years. Environmental class action lawsuits are on the rise, as China confronts major environmental problems. In addition, with increased worries about product safety, Chinese consumers are likely to seek greater enforcement of consumer protection laws. A narrow textualist interpretation of the new Company Law suggests that the Company Law's veil piercing provisions may not cover all such litigation.[142]

### g. Moving Beyond Corporate Veil Piercing?

The above brief review of the position in the UK, Australia, Hong Kong and China makes clear that the existing veil piercing jurisprudence falls short of offering adequate protection against those companies which are part of a corporate group and may structure their business in a way to avoid legal liability. Of course, courts in common law jurisdictions have developed various exceptions to the twin principles. Courts may, for example, lift the veil and disrobe the separate personality of a corporation when the subsidiary was a sham, or used as a 'cloak' for fraud or illegality, or when it was a 'puppet' of the owner.[143] In practice, however, it has not been easy for the victims to bring cases within the parameters of these exceptions and convince the courts to pierce the veil so as to make

company is independent from his own property, he shall bear joint liabilities for the debts of the company.'

[140] Koh, n 107, 90. 'Article 20 establishes a basic structure for lifting the corporate veil.' Id, 92.

[141] In addition to the express language of Article 20, the commentators also explain the scope of this provision only with reference to creditors. Gu, n 109, 334.

[142] Wu, above n 138, 334-35 (footnotes omitted).

[143] See, for example, *Walkovsky v Carlton* 276 NYS 2d 585, 223 NE 2d 6 (1966); *Wallersteiner v Moir* [1974] 3 All ER 217; *Tata Engineering & Locomotive Co Ltd v State of Bihar* AIR 1965 SC 40; *LIC v Escorts Ltd* AIR 1986 SC 1370; *Adams v Cape Industries plc* [1991] 1 All ER 929. See also Paul Davies, *Gower & Davies' Principles of Modern Company Law*, 7th ed (London: Sweet & Maxwell, 2003), 181-90; Roman Tomasic, Stephen Bottomley & Rob Mcqueen, *Corporations Law in Australia*, 2nd ed (2002), 2-50.

the parent corporation liable.[144] As parent corporations keep *distance by design*, courts generally expect an unreasonably high standard of proof and in view of problems of fluctuating judicial discretion, it is almost impossible for the victims to feel confident that they could pierce the veil.[145] Considering some past evidence, it also seems that the courts might be less willing to pierce the corporate veil in cases involving human/labour rights and the environment as compared to cases related to anti-trust or tax evasion.[146]

It is, therefore, time to look beyond the current judicial veil piercing jurisprudence as a check against the corporate misuse of the principles of separate personality and limited liability.[147] Professor Blumberg has made a forceful plea for recognising the enterprise principle in situations involving human rights violations by subsidiaries.[148] This principle may also be provided a legislative basis, as the UK's Corporate Responsibility Bill 2002 attempted to do, albeit unsuccessfully.[149]

The theory of 'limited eclipsed personality' could provide another alternative solution.[150] The concept of *eclipsed personality* implies 'that in cases of alleged human rights violations, the separate personality of the subsidiaries of a corporate group should be eclipsed in that victims should be free to sue the immediate or ultimate parent corporation of

[144] Joseph, above n 130, 129-43.
[145] Deva, 'Overcoming Hurdles', above n 19, 101-04.
[146] An empirical investigation by Thompson shows that 'courts pierce [the veil] less often in tort than in contract contexts, and a piercing decision is not less but more likely when the shareholder behind the veil is an individual rather than another corporation.' Robert B Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 *Cornell Law Review* 1036, 1038 and also 1056, 1068–9.
[147] See Muchlinski, *MNEs and the Law*, 330-33; Jennifer A Zerk, *Multinational and Corporate Social Responsibility: Limitations and Opportunities in International Law* (Cambridge: Cambridge University Press, 2006), 215-34.
[148] Blumberg, 'Conceptual and Procedural Problems', above n 36; Philip I Blumberg, 'The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities' (1996) 28 *Connecticut Law Review* 295; Blumberg, *The Search for a New Corporate Personality*, above n 113. See also D Aronofsky, 'Piercing the Transnational Corporate Veil: Trends, Developments and the Need for Widespread Adoption of Enterprise Analysis' (1985) 10 *North Carolina Journal of International Law & Commercial Regulation* 31; Cindy A Schipani, 'Infiltration of Enterprise Theory into Environmental Jurisprudence' (1997) 22 *Iowa Journal of Corporation Law* 599; Meredith Dearborn, 'Enterprise Liability: Reviewing and Revitalising Liability for Corporate Groups' (2009) 97 *California Law Review* 195.
[149] Corporate Responsibility Bill 2002 (UK), Section 6: http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmbills/145/2002145.pdf (21 January 2010).
[150] Deva, 'Overcoming Hurdles', above n 19, 104-09. Any attempt to limit the principle of limited liability is bound to attract academic (in addition to corporate) resistance. See, for example, Stephen B Presser, 'The Bogalusa Explosion, "Single Business Enterprise," "Alter Ego," and Other Errors: Academics, Economics, Democracy, and Shareholder Limited Liability: Back Towards a Unitary "Abuse" Theory of Piercing the Corporate Veil' (2006) 100 *Northwestern University Law Review* 405.

that group as a matter of principle.'[151] The theory is 'limited' in its scope because, firstly, it is applied to determine the question of liability only within a corporate group, and secondly, the separate personality of the subsidiary of a corporate group is eclipsed only in those cases that involve the violation of human and labour rights.[152]

## 5. Conclusion

It is not a given, irreversible fact that companies should focus only on maximising shareholders' profit or that directors cannot take into account stakeholders concerns or that a parent company cannot be held liable for the wrongful conduct of its subsidiaries. Companies have come to enjoy these privileges by virtue of law. In fact, historically companies were entities created by a specific and revocable charter, to serve a social purpose, and operate on a non-profit basis. They were also not allowed to own shares in other companies.

Law is a means to serve society and in different points of history, company law made different changes in the structure, composition and rights of companies. There is no good reason why law (but for the political will) cannot again respond to societal needs and mould the institution of corporation.

In this article, I have tried to argue that if companies have to play a role in promoting sustainable development, we cannot achieve this goal effectively through unsustainable company laws. The current company law framework is by and large unsustainable because it does not encourage companies to embrace social responsibilities and pursue sustainable business. In fact, some may argue that company law discourages companies from participating in the sustainable development project. It does so, for instance, by mandating directors to focus solely on safeguarding shareholders' interests or by promoting parent companies to disown deviant behaviour of their subsidiaries.

As I have highlighted, some positive signs are visible in recent years in various jurisdictions. But it is still too early to say if company law would take the full step forward to let stakeholders claim their legitimate interests in the institution of the corporation. If company law continuously fails to meet societal expectations, the future of the corporation and its legitimacy might be at stake.

[151] Deva, 'Overcoming Hurdles', above n 19, 106.
[152] *Id*., 107.