Study on Extraterritorial Application of Home States’ Law to Transnational Corporations for Environmental Governance

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Abstract: Transnational corporations play important roles in improving international economic development, whereas they cause some environmental problems in host states. Through comparing and analysing possible legal mechanisms, the authors hold that extraterritorial application of home states’ law to transnational corporations for environmental governance is more hopefully to solve relevant environmental problems. And relevant theories and practices of current Code of Conduct Bills and Human Rights Due Diligence Laws are explored. In the meanwhile, to improve this legal mechanism, several obstacles need to be overcome. They are infringement of sovereignty, insufficient motivation, environmental regulation imbalance and legislation escape. Correspondingly, relevant problems can be solved through indirect control on foreign affiliates, multilateral actions, soft regulations, and so on.

Keywords: Extraterritorial Application of Law; Transnational Corporation; Home State; Environmental Protection; Human rights

1. Introduction

With economic globalization, transnational corporations expand their influence all over the world. To achieve profit maximization, some parent companies establish polluting foreign affiliates in other countries, especially in countries provide lower environmental standards. In the meanwhile, potential threats towards environment are also introduced. Under these circumstances, it is significant to explore possible legal solutions. And extraterritorial application of home states’ law to their transnational corporations for environmental governance is hopefully to solve this problem.

Currently, scholars have explored the theory of extraterritoriality,[1][2] especially the extraterritorial application of multilateral environmental agreements and possible extraterritorial jurisdiction issues over transnational corporations for environmental crimes. As for sovereignty issues relating to extraterritoriality, the conception and foundations of sovereignty is reconstructed, and it is suggested to avoid violation of sovereignty through indirect extraterritorial application of national law, such as unilateral extraterritorial application of law. Besides, cooperative state action is necessary. Specifically, the practices of corporate social responsibility conduct and extraterritorial application of environmental laws in the European Union, the United States, Australia and Singapore have been introduced. Particularly, after the European Union established the Emissions Trading Scheme, the European Court of Justice had to rule on the EU’s jurisdiction to regulate the emission of greenhouse gases over a foreign territory. And relevant study would have far-reaching implications for extraterritorial application of EU law.

Notwithstanding, relevant research still faces several challenges.[3] For instance, theoretical foundations and enforceability of this mechanism should be clarified further. And several problems relating to this legal mechanism should be analysed and resolved. Therefore, this paper aims at providing a systematic analysis of possibility and practicality of extraterritorial application of home states’ law to transnational corporations for environmental governance. In the meanwhile, this paper also summarizes potential challenges that may be faced by the application of this mechanism and provides corresponding solutions.

The rest of this paper is organized as follows. The second section introduces relevant environmental problems caused by transnational corporations, and possible legal mechanisms used to date to address relevant issues, and their failures. The third section provides theoretical and practical analysis of current
Code of Conduct Bills and Human Rights Due Diligence Laws, and compares relevant practices in several regions. The fourth section points out potential challenges relating to the implementation of these mechanisms and corresponding solutions. And the last section concludes this study with major contributions and possible future work.

2. Transnational Corporations and Environmental Problems

Generally, transnational corporations are defined as “incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates”[^4^]. According to United Nations Conference on Trade and Development, a parent company is defined as a company that controls assets of other affiliates in countries other than its home country, generally by owning a certain equity capital stake. “An equity capital stake of ten per cent or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for an unincorporated enterprise, is normally considered as a threshold for the control of assets…” In the meanwhile, this foreign enterprise can be regarded as its foreign affiliate.

According to the World Investment Report 2019, global foreign direct investment (hereinafter referred to as FDI) reached $1.3 trillion. In the meanwhile, international production continues to expand. Estimated values for sales and value added of multinational enterprises’ foreign affiliates rose in 2018 by 3 per cent and 8 per cent, which suggests that foreign affiliates are able to extract increasing value from their operations. Currently, FDI stock were concentrated in several sectors, including telecommunication, trade, business activities, finance, manufacturing and so on, where a lot of multinational enterprises took part in. Hence transnational corporations play an important role in current international economic development, and our daily lives.

As a coin has two sides, transnational corporations may bring benefits for environmental protection when they produce and provide environmentally friendly technologies and equipment, whereas they may cause pollution problems, which have bad effects on environment. In recent years, transnational corporations have increasingly been accused of making environmentally degrading activities through their foreign affiliates, especially in underdeveloped countries.[^5^]

To enhance environmental protection and get political supports, governments of some countries which develop high information and communication technologies are inclined to forbid industrial activities which may cause severe pollution problems or cost too much in environmental governance within their territories. Moreover, the Kyoto Protocol (1998) requires contracting parties to achieve certain targets of emission reduction, which is another pressure for relevant governments to control its pollution industrial activities. Then relevant parent companies relocated these factories in other countries through establishment of foreign affiliates.[^6^] Under these circumstances, transnational corporations caused environmental degradation in some host states.

Theoretically, there are two ways to deal with these environmental problems caused by transnational corporations. One way is requiring them to comply with more stringent environmental standards through some legal mechanisms, and reducing risks of causing huge environmental damage. The other way is providing and improving possible legal remedies for victims of environmental damage caused by transnational corporations, and enhancing their access to justice.

Currently, the second method is probably unpractical because there is no widely recognized uniform standard of piercing the corporate veil doctrine, and there are a lot of uncertainty about jurisdiction and choice-of-law issues in cross-border environmental tort litigations. For instance, in the United States, scholars have studied corporate liability under Alien Tort Statute. With existence of opposing views, more scholars suggest relevant courts to hear cross-border environmental tort cases under Alien Tort Statute, on the ground of lacking adequate forums or development of a global human rights regime. However, in practice, none of relevant cases has been successful. In the European Union, several judgments have shown a trend that relevant courts have jurisdiction over the claims against parent companies and foreign affiliates. However, this trend has not been recognized in law. And the other countries have similar situations. Therefore, it is necessary to explore other legal mechanisms to deal with environmental problems caused by transnational corporations.

3. Practicalities of Extraterritorial Application of Home States’ Law

Extraterritorial application of relevant regulations can solve the problem of unbalanced environmental regulations in home states and host states. This mechanism aims to increase environmental
standards generally. Hence it enhances environmental protection in the states providing lower environmental standards. In the meanwhile, complying with higher environmental standards result in lower possibilities of environmental pollution and damage. Therefore, the mechanism brings benefit to environmental protection and protection of potential victims’ interests.

However, relevant theoretical basis of this mechanism needs to be further clarified. In the meanwhile, several countries and regions have initiated Code of Conduct Bills and Human Rights Due Diligence Laws to practice this mechanism. And relevant practices should be comparatively analysed and improved.

3.1. Theoretical Exploration

Extraterritorial application of law relates to the power of a State to apply its national law to foreign elements, namely the issue of legislative jurisdiction.

In international law regime, Cook holds that international law imposes no limits on legislative jurisdiction of countries for private law issues. In the meanwhile, Joseph Story holds that a State can legislate for its subjects abroad with some restrictions. For instance, the extraterritorial legislation should not infringe the sovereignty of other countries, or relevant laws would be denied enforcement in other States. Moreover, Mann believes that a state can apply its national law when there is a close connection between the State and the person, thing, or event. And Mann holds that the law can be applied extraterritorially only if the law has clear words to do so. In the meantime, research on extraterritorial application of national law has already initiated in antitrust law, security law and labour law.

Therefore, extraterritorial application of home states’ law is theoretically supported.

For one thing, previous research has already established theoretical foundations for extraterritorial application of national law. According to relevant analysis, extraterritorial application of national law would be permitted on limited grounds. For instance, once there is a close connection between the State and the person, thing, or event, extraterritorial application of certain national law is theoretically supported. And the common need for environmental protection in home states and host states is the close connection which provide this support.

Moreover, to live in a healthy environment is one of the basic human rights. Currently, it is well recognized that States should make efforts to regulate the conduct of their transnational corporations, in order to prevent human rights abuses and environmental damage. At the same time, the States should also provide greater access for victims to effective remedies. The UN Guiding Principles on Business and Human Rights 2011 also provides similar provisions. Hence extraterritorial application of home states’ rules to foreign affiliates is justified not only because their activities affect the interests of the home states, but also they affect the interests of the host states and international ones. Therefore, it is justified and reasonable for home states to impose internationally recognized environmental protection obligations on foreign affiliates through extraterritorial application of relevant regulations.

For another thing, the special structure of transnational corporations provides possibilities for home states to extraterritorially control on relevant foreign affiliates. With economic development and technology improvements, it is easier for parent companies to reach their foreign affiliates. Generally, parent companies can share benefits with foreign affiliates and participate in their managements. And home states of parent companies, which directly regulate on parent companies, also have close connections with relevant foreign affiliates. And it is possible to extraterritorially apply its national law to corresponding corporations.

Therefore, it is justified and feasible for home states to impose internationally recognized environmental protection obligations on foreign affiliates through extraterritorial application of national law. And there are adequate theoretical supports for this mechanism.

3.2. Practical Analysis

Currently, several countries have initiated extraterritorial application of national law to their transnational corporations, especially through initiating Code of Conduct Bills and Human Rights Due Diligence Laws, such as the North American countries, the European Union Member States and Australia.

3.2.1. North American Countries

In 2000, Corporate Code of Conduct Act (1990-2000) was presented in the US House of Representatives, which was an attempt to extraterritorial application of national law. The Code requires
the nationals which employ more than 20 persons in foreign states should take necessary steps to implement this Code, either directly or through subsidiaries, subcontractors, affiliates, joint ventures, partners, or licensees (Section 3). Relevant requirements include providing safe and healthy workplaces, ensuring fair employment, and upholding responsible environmental protection and environmental practices. As for the enforcement methods, the Code requires that domestic authorities should give preference to entities adopting and enforcing this Code, and terminate contracts entered into with the noncomplying entity (Section 4). In the meanwhile, the United States should establish a private right of action to petition in order to investigate alleged Code compliance violations (Section 5).

This Corporate Code of Conduct Act is a beneficial attempt of extraterritorial application of national law, although it has not been promulgated. According to this Act, extraterritorial application of national law on foreign affiliates are achieved through control on parent companies. Through giving preference to complying entity and terminating contracts with non-complying entity, it creates motivations for parent companies to enhance management on their foreign affiliates. Hence it could help to solve enforcement problems in extraterritorial application of national law. However, the liability of parent companies and their foreign affiliates is not regulated clearly.

In Canada, an Advisory Group recommended Canada to develop a Corporate Social Responsibility framework composed of standards for Canadian extractive sector companies in 2007. In 2009, Canadian government issued a policy relating to the corporate social responsibility strategy for the Canadian international extractive sector. This policy proposes that Canada’s Department of Foreign Affairs and International Trade and Natural Resources Canada should regulate international corporate social responsibility performance guidelines for Canadian transnational corporations, and establish an Office of the Corporate Social Responsibility Counsellor.

The office of the Corporate Social Responsibility Counsellor is the implementation organization of this mechanism, which aims at solving disputes and complains relating to extractive activity abroad in a timely and transparent manner. According to relevant rules, the Corporate Social Responsibility Counsellor accepts complaints and public consultations from Canada and overseas. The Corporate Social Responsibility Counsellor should report to and accountable to the Canadian Minister of International Trade. In 2011, the Review Process Participant Guide was released, and regulated that any individual and group reasonably believed it is affected by activities of Canadian extractive sector companies can complain to the Counsellor. However, the express written consent of the parties involved is required before the Counsellor takes a review. During the review, the Counsellor can only apply the designated performance guidelines, such as IFC Performance Standards and OECD Guidelines for Multinational Enterprises, and cannot make binding recommendations. Once the Counsellor finds the companies are inconsistent with performance guidelines, it can make recommendations to the companies, but without sanction.

Above legal mechanism is an attempt of transnational private regulatory governance regime because its implementation requires both parties’ consent which can be withdrawn at any stage. Hence it is distinguished from traditional public law regimes. This transnational private regulatory governance regime helps to implement extraterritorial application of home states’ law to foreign affiliates, and solve disputes relating to transnational corporations beyond the walls of host states. And it reduces the concerns of most developing countries of neo-colonialism. However, without forceful enforcement mechanism, their effects of enhancing environmental protection in host states are doubtful.

Overall, these attempts were not successful, because relevant Conduct Codes were not adopted, and relevant private regulatory governance regime was suspended. Currently, with the development of mandatory due diligence human rights legislation all over the world, the United States House of Representatives Committee on Financial Services began to discuss on draft of a bill that would require relevant companies to conduct human rights due diligence on 10th July 2019. This Bill requires relevant companies to undertake an annual analysis to identify human rights risks and impacts in their operations and value chain, whereas it does not create liability for adverse human rights impacts, or regulates right of action on the part of victims. Relevant development needs to be observed.

3.2.2. European Countries

The European Union has recognized and developed the legal mechanism of extraterritorial application of environmental law for a period. In the meanwhile, the European Union was one of the first regions that began to develop mandatory due diligence law regarding human rights, environment, and good governance all over the world.

Generally, there are three generations of human rights due diligence legislation in the European Union.
The first generation was about human rights due diligence reporting obligation, and the Non-Financial Reporting Directive (2014) was one of the examples. The second generation stipulates a broader human rights due diligence obligation, such as measures taken and results report, and the requirements for importers of conflict minerals and timber products was examples. The third generation was starting in 2017, when France promulgated the French Duty of Vigilance Law, and the Swiss Citizen Responsible Business Initiative was taken. This generation shows the growing acceptance for mandatory human rights due diligence legislation.

In September 2020, the European Parliament’s Committee on Legal Affairs published a draft report requesting the European Commission submit legislative proposal on mandatory supply chain due diligence that would cover environmental risks across entire supply chains of companies. In detail, relevant companies are required to conduct and impact assessment about whether their foreign affiliates or suppliers cause or contribute the environmental risks, namely potential or actual adverse impact that may impair the right to a healthy environment. Then relevant companies should publish a statement if they believe that they do not cause or contribute to such risks, or they must establish a due diligence strategy and communicated to relevant subjects. In the meanwhile, this draft report also included some suggested penalties for companies that fail to prevent adverse environmental impacts, including criminal ones. As for jurisdiction and choice-of-law issues of cross-border environmental disputes, this report also proposed an amendment to the Rome II regulation to include a specific choice-of-law provision and to the Brussels I regulation to establish extraterritorial jurisdiction.

Therefore, extraterritorial application of national law for human rights due diligence is relatively developed in the European Union. In the first place, the scope of relevant regulations is entire value chain of relevant companies, regardless of their size. Hence relevant due diligence law has large application scope in the European Union. The foreign affiliates of the European parent companies should comply with environmental requirements of their home states.

In the second place, relevant due diligence law in the European Union is developing from voluntary basis to mandatory basis. Businesses in the European Union are required to comply with due diligence requirements and relevant penalties are regulated for businesses that fail to prevent adverse environmental impacts. Hence the implementation of extraterritorial application of national law in the European Union is guaranteed by legal mechanisms. And relevant governments have power to enforce these regulations. Through controlling on parent companies, the European Union established an effective legal mechanism to implement extraterritorial application of national law for human rights due diligence.

In the last place, due diligence legislation in the European Union also mentioned jurisdiction and choice-of-law issues of cross border environmental disputes involving European parent companies. The draft report issued by the European Parliament suggested to modify the Rome II and Brussel I regulation, and provide opportunities for foreign victims of environmental damage to file lawsuits in the European Union. Hence this regulation helps to provide legal remedies for victims of environmental damage caused by transnational corporations.

However, this European Union model has not been accepted by other countries and regions.

4. Possible Obstacles Analysis

4.1. Infringement of Sovereignty

The mechanism of extraterritoriality application of home states’ law to transnational corporations would infringe the sovereignty of other countries. Therefore, its legitimacy needs be analysed. Generally, sovereignty means the power of a country to control its government, and the power or authority to rule. Although the development of globalization is challenging the traditional concept of sovereignty, it is still the most important fundamental concept of international order.

Theoretically, it is reasonable to apply this mechanism when dealing with environmental issues. For one thing, relevant mechanisms are beneficial for citizens’ health in host states and the environment thereof, because higher environmental standards and stringent regulations would contribute to enhance environmental protection in host states. Besides, more and more countries have recognized people’s environmental rights in their constitutions. Relevant mechanism is in accordance with the requirement of human development and environmental protection. Moreover, natural environment is very fragile, and the ecosystem of the world is an entirety. The pollution and ecological damage of one country would have a bad effect all over the world in the long run. In the meanwhile, most natural resources are limited,
and the exploitation has externalities. Hence it is reasonable to put up specific mechanisms to deal with special environmental issues.

For another thing, it should be noted that these mechanisms would open another door to deal with environmental problems caused by transnational corporations. Compared with the possible infringement of sovereignty of host states, it would also bring some benefits. At the same time, the possible infringement of sovereignty of host states can be controlled through home states enforcement and restricting the scope of extraterritorially applied rules. The private regulatory governance regime and control on parent companies are both examples. Hence in practice, the influence of relevant mechanisms on sovereignty of host states would be very limited, because relevant regulations would be mostly enforced in home states.

4.2. Insufficient Motivation

Home states may be reluctant to apply this legal mechanism, because it would put their transnational corporations at a competitive disadvantage place, and increase burdens on their relevant organizations. In a host state, the operating costs of foreign affiliates which comply with lower environmental standards would be lower than those following higher environmental standards and have a competitive advantage over the latter. In the meanwhile, to extraterritorially apply national law, home states must prepare corresponding organizations and competent staffs. The organizations should collect information on environmental issues linked with relevant foreign affiliates, deal with relevant complains, petitions and disputes. Besides, it would be necessary to modify existing legislation and make changes to the judicial system. All these changes would be extra burdens on home states.

However, this problem could be solved. For one thing, with public environmental awareness increase, the extraterritoriality measures taken by home states would have public opinion foundations.

For another thing, multilateral action is a very useful method to overcome this obstacle. The application of Foreign Corrupt Practices Act is one of the examples. At first, businessmen of the United States criticized Foreign Corrupt Practices Act for putting American businessmen at a competitive disadvantage place, because transnational bribery was not criminalized by home states of their competitors. Then the response of the United States was asking for multilateral action. In 1988, the Foreign Corrupt Practices Act was amended, and the United States began to pursue a similar convention among the Organization for Economic Cooperation and Development (hereinafter referred to as OECD) members. On 15 February 1999, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions came into force, and a revised recommendation was adopted in 2009. In 2017, a report expressed that the transnational corporations which were subject to this Convention were less likely to engage in bribery than companies that were operating in non-member states. Therefore, multilateral action would help encourage more countries to accept relevant mechanism.

One example of these attempts is the proposal of establishing an EU-China dialogue on human rights supply chain due diligence. Besides, human rights due diligence is also negotiated on international level. An open-ended intergovernmental working group on transnational corporations and other business enterprises with respect to human rights was established in 2014 by United Nations Human Rights Council. And human rights due diligence is also part a new draft UN Binding Treaty on human rights and business, which is currently being negotiated. The progress achieved through multilateral actions would motivate more countries and regions to establish relevant mechanisms, and solve the problems of insufficient motivation of home states. Moreover, economic incentives are also useful methods to attract member states to accept more environmental obligations. In this context, it is also strongly suggested the international community dealing with environmental issues and other human rights issues separately in order to increase feasibility of this mechanism.

4.3. Environmental Regulations Imbalance

Above analysis is based on one assumption that home states have more stringent environmental regulations. However, this assumption is not completely in line with facts. Besides developed countries with higher environmental standards, countries with lower environmental standards can be home states of transnational corporations. Especially in recent years, more and more corporations of developing countries began to invest worldwide. For instance, BRICS-based corporations are increasingly active investors worldwide. The group is home to 24 per cent of the world’s 500 largest corporations. However, although these economies are experiencing rapid economic development, their environmental regulations
may not be the same “advanced”.

To deal with these situations and make extraterritorial application of home states’ law more practical, we should further explore the original purpose of this mechanism. It is suggested that more stringent environmental regulations should be applied to relevant foreign affiliates. Hence possibility of environmental damage caused by transnational corporations would be reduced. However, it is hard to compare environmental laws of different countries directly. Under these circumstances, it is recommended that home states extraterritorially apply their law to transnational corporations, and control environmental behaviours of their foreign affiliates. Then governments of home states could enhance environmental governance to their transnational corporations, and make their foreign affiliates comply with more stringent environmental standards through this mechanism. In the meanwhile, governments and relevant authorities of host states should make sure that their environmental regulations are complied with by those foreign affiliates which are established within their territories.

Therefore, more stringent environmental regulations would be applied. Both host states and home states of transnational corporations are responsible for their law’s enforcement. And relevant transnational corporations should comply with more stringent environmental regulations, no matter they are regulations of home states or host states.

### 4.4. Legislation Escape

Above analysis is based on one assumption that home states have more stringent environmental regulations. Last but not the least, the possibility of escaping this legislation should be studied and illustrated. For economic and other possible benefits, transnational corporations may try to find ways to get around this regulation, in order to reduce their potential responsibilities and overall operating costs. For instance, the parent companies may loosen the links with their foreign affiliates, or even cut off their relationships and keep them as external partners. To deal with this potential obstacle, there are two things to be analysed: (1) if transnational corporations have sufficient motivation to take above measures to escape this regulation; (2) and what are possible corresponding measures.

For the first question, the answer is that transnational corporations would not have sufficient motivation to escape relevant measures through loosening the links with their foreign affiliates. For one thing, the structure of transnational corporation has its irreplaceable advantages. For instance, different from domestic enterprises which mainly do business in the domestic market, transnational corporations focus on the international market, with the aim of maximizing global profits. Therefore, compared with domestic enterprises, transnational corporations have economic entities in foreign countries, and they may implement centralized and unified management of their foreign affiliates. At the same time, relevant capital, production, management, technology, and information can be managed and distributed between parent companies and foreign affiliates in line with the company’s overall strategy and under the control of parent companies. Therefore, transnational corporations are sufficiently motivated to keep their structures, and do not escape from this legislation.

For another thing, clear definitions of parent companies and foreign affiliates, and clear statement of law’s scope would contribute to the enforcement of relevant mechanisms. As an important precondition, the definitions of parent companies and foreign affiliates should be determined clearly. Generally, an equity capital stake of ten per cent or more of the ordinary shares or voting power for a company, is normally considered as a threshold for “control”. And the controlling corporations are parent companies, while the controlled corporations are subsidiaries.

As for the second question, relevant extraterritorially applied law could clearly define their application scope, to deal with potential escapes. For instance, the French Corporate Duty of Vigilance Law (2017) provides that it applies to activities of parent company itself, companies it controls directly or indirectly, subcontractors and suppliers with whom it maintains an established business relationship. Moreover, this Law also provides the specific criteria of companies that should be covered by this Law.

### 5. Conclusion

To deal with environmental problems caused by transnational corporations, legal community began to study on extraterritorial application of home states’ law to transnational corporations. However, a systematic and improved approach to this mechanism still needs to be explored. Based on theoretical and practical analysis of this mechanism, the authors strongly believe that extraterritorial application of environmental law would be hopefully to deal with environmental problems caused by transnational
corporations. In the meanwhile, several obstacles need to be overcome when applying this mechanism. They are infringement of sovereignty, insufficient motivation, environmental regulation imbalance and legislation escape. Correspondingly, relevant problems can be solved through indirect control on foreign affiliates, multilateral actions, soft regulations, and so on.

In a few years, extraterritorial application of home states’ law towards environmental issues involving transnational corporations would be further explored both at the international level and national level, especially in the United States, the European Union, and China, which have most large transnational corporations. In the meanwhile, relevant multilateral agreements also rely on the active participation of these countries and regions. Therefore, a long-term observation should be made on possible practices of relevant international cooperation.

References