Foreword

Constitutionalization and the regulation of transnational firms

The constitution of governance in the global sphere has transformed dramatically in the past half century. Governance, at whatever level of social organization it takes place, refers to the system of authoritative rules, norms, institutions and practices by means of which any collectivity, from the local to the global, manages its common affairs. Historically, States were the sole constituent and constitutive units of global governance. They were the rule makers. They were also the subjects of the rules they made. International law applied to them and only through them to other actors – whether individuals, companies, or armed factions – and States were the enforcers of those rules, when they were willing to and capable of enforcing them. Globalization has changed that. States now share governance in the global sphere with other self-constituting actors that have global reach. This book explores how and why this has occurred, and what the implications are for dealing with global challenges – be they climate change, realizing human rights or the capacity of States themselves to pursue a wide range of issues in the public interest.

Perhaps nowhere is this transformation more pronounced than in the realm of corporate globalization, the focal point of this book. This is the realm inhabited by some 80,000 multinational corporations, many with hundreds of subsidiaries and affiliates, and millions of suppliers around the world. States made corporate globalization as we know it today possible, through privatization, liberalization, offshoring, providing enforceable investor protections, and the commercialization of sovereignty itself – not merely routine competition for foreign investment, but also deliberately creating havens for avoiding corporate taxation, regulation and transparency.

A number of underlying legal principles fundamentally shape the political status and roles of multinationals today, whether as subjects or sources of governance. These principles stem from the early days of corporate or company law, in some cases going back to the nineteenth century, originally intended to facilitate capital formation among natural persons. They include attributing legal personhood to corporations, thereby enabling the corporate entity itself to own property, enter into contracts, and to sue and be sued; limiting the liability of shareholders to the extent of their investments; and permitting one corporate entity to own another while still being construed as separate and distinct legal persons. Twenty-first century corporate globalization is built on these principles from a distant past and an entirely different economic reality.

For analytical purposes it is necessary to distinguish between our everyday image of a multinational corporation and its legal structure. We think of Exxon, GE, Siemens, Unilever, Sinopec, Google, Coca-Cola, Toyota, Novartis, SAB Miller and so on down the list of well-known names as *one* company, with unity of command, operating under a single global vision and strategy, optimizing its worldwide operations for efficiencies, market share and profits.

We are not wrong to think this. Those entities do exist in the everyday world of economic activity. But they don't exist as such in the legal world. In legal terms, each unit of a global corporate group is a separate legal entity, subject to the laws of the jurisdiction in which it is incorporated. Hence Jean-Philippe Robé insists that the first step in fully understanding the multinational in relation to governance issues is to differentiate between the single *economic* entity that organizes and controls its entire global activities, which he suggests we call the *multinational firm* or *enterprise*, and the complex clusters of individual *legal entities* held together through equity relationships and bundles of contracts that make up the corporate group. Domestic law for the most part governs only the individual legal entities operating within the separate jurisdictions, not the single global economic organization. International law barely recognizes the existence of multinational enterprises at all; indeed, a number of scholars go so far as to describe it as invisible.

The disjuncture between economic and legal entities provides multinational enterprises with sources of considerable power vis-à-vis other and typically more localized stakeholders, including States. This includes the instrumental power of, for example, coordinated global lobbying and mobilizing political support; the structural power that is inherent in making locational decisions or being able to transfer risk and obligations onto other parties; and the discursive power of framing and defining policy issues in a manner consistent with their interests. Thus, multinational enterprises have become a significant *constituent* unit in global governance.

Even more important, multinationals have become a *constitutive* unit in global governance by virtue of the authority they exercise. They exercise authority through the private law of contracts, the new *lex mercatoria,* which can affect workplace conditions, the welfare of communities and environmental practices in more jurisdictions than there are UN member States – and which can be more effectively enforced than the typical UN resolution and convention. Moreover, multinational enterprises exercise authority in relation to States themselves through binding international arbitration provisions in investment agreements. These give multinationals legal standing to sue States for damages, not only in cases of expropriation without prompt and adequate compensation, but also if the economic equilibrium that existed when the investment was made was upset through policy measures that an arbitration panel might construe as uncompensated regulatory takings, which can include progressive labor regulations, human rights standards and environmental requirements. International arbitration panel judgments are enforceable in the domestic courts of the more than 150 States that have ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention.

That is what the contributors to this volume mean when they say that the constitution of governance in the global sphere has been transformed. They also use the term "constitution" in two other ways.

The first is that the global governance role of multinational enterprises has become "constitutionalized" in the sense that it has acquired an existential basis apart from States' discretion. At the foundation of this status, as Robé elaborates, are private property rights and freedom of contract – sacrosanct and codified in the liberal societies in which they first emerged as constitutional prerogatives of autonomous natural persons. Today they form the authoritative basis for the agglomeration of worldwide multinational enterprises as legal persons. Crucially, even States that have no political liberal institutions domestically, such as China, have been obliged to adhere to this transnational authority structure in order to participate on equal terms in the global economy, as when they accede to the World Trade Organization (WTO), for example, or sign up to the international investment regime. Of course, host States

have a significant say in the day-to-day operations of multinational enterprises. Compliance with applicable laws is a formal requirement, though it is not always rigorously enforced. The State can require the multinational to take on local joint venture partners. It may require the company to obtain all manner of permits for its legal license to operate. It negotiates the payments the company must make in taxes and royalties. It can refuse access to particular sites. Competition authorities regulate mergers and acquisitions – and so on. Such State-based constraints on the extended enterprise's authority to conduct its own affairs across and within States are but limited incursions into the foundational principles of private property rights and freedom of contract. They do not challenge the constitutive principles themselves.

Yet another way the term "constitution" is used by the contributors to this book is in asking the question whether – and if so how – it might be possible to subject the self-constituting multinational enterprise to global constitutional constraints that more clearly express the needs of people and planet, rather than the narrow pursuit of economic gain. All are agreed that a single "global constitution" is impossible to achieve in practice and is undesirable if not frightening on normative grounds. Beyond that, a number of options are explored. They range from efforts to construct interlocking State-based international administrative and judicial bodies; trying to put the genie back in the bottle through national legal changes coupled with transnational cooperation; learning to live with global constitutional pluralism; and injecting what Robé calls "micro-devices" into the existing systems of governance, national and international, public and private, intended to move them in the desired direction. These options are meant to be invitations to further thinking and debate, not as preferred or mutually exclusive alternatives.

I was asked to write this Foreword because, in addition to my academic work on closely related subjects, I have held UN leadership positions in two initiatives that explicitly recognize this transformation in global governance as they seek to advance the People and Planet agenda. One is the UN Global Compact, the other the UN Guiding Principles on Business and Human Rights. Both help to illustrate some of the theoretical arguments in subsequent chapters.

The Global Compact was launched by then UN Secretary-General Kofi Annan in June 2000; at the time I served as his Assistant Secretary-General for Strategic Planning. It was established to pursue two complementary objectives: to mainstream within the business community ten principles drawn from UN declarations and conventions in the areas of human rights, labor standards, environmental precaution and anticorruption; and to encourage business support for broader UN goals, such as poverty reduction. The Global Compact had no intergovernmental mandate to regulate. Instead, it was designed as a platform to engage business. It does this by providing a learning forum (identifying and sharing dilemmas and best practices); promoting public/private partnerships; and generating innovative spin-offs that then acquire lives of their own, such as the Principles for Responsible Investment, which now involves more than 1,300 investment institutions with $45 trillion in assets under management, committed to including environmental, social and governance criteria in their investment decisions and to being active investors.

Today, the Global Compact is the world's largest corporate citizenship initiative, with 8,000 business and 4,000 nonbusiness participants (labor, civil society, academic institutions and even cities), as well as national networks in more than eighty countries. Critics like to point out that it lacks an enforcement mechanism – but that assumes it was intended to regulate or police. In contrast, its contribution is in establishing, connecting and supporting communities of practice; expanding cognitive and institutional horizons among firms and other stakeholder groups; and normalizing corporate responsibility discourse, particularly

in emerging markets and developing countries, including the BRICS, where the UN brand opens doors more readily than private sector or civil society initiatives alone. In short, the Global Compact is a real-world example of what Robé calls "micro-devices", intended to promote a more social conception of the firm within the business community itself.

The second initiative is the UN Guiding Principles on Business and Human Rights. It builds on but goes well beyond the Global Compact. Attempts to subject multinational enterprises to an overarching international treaty instrument go back to the 1970s. Each has failed. The most recent instance focused specifically on human rights. It was called the Norms on Transnational Corporations and Other Business Enterprises with Regard to Human Rights ("Norms"), and was drafted by an expert working group of a subsidiary body of the UN Commission on Human Rights, the institutional predecessor of today's Human Rights Council. The Norms would have imposed human rights duties on business enterprises directly under international law, whereas international law typically imposes duties on States, which are then free to ratify (or not) the legal instrument and incorporate its provisions into domestic law. The Norms were vigorously opposed by business and most States, but had strong support in the human rights advocacy community. At its 2004 session, the Commission declined to adopt the text, pointedly noting in a resolution that it "has not been requested by the Commission and, as a draft proposal, has no legal standing." But governments felt under enough pressure to keep the issue on the agenda, so in 2005 the Commission requested the UN Secretary-General to appoint a Special Representative to start the process over again. Kofi Annan appointed me to the post. My initial mandate was modest: to "identify and clarify" prevailing standards and best practices in the area of business and human rights, to elaborate the meaning of the concepts "corporate complicity" in human rights abuses as well as "the corporate sphere of influence", and to make recommendations.

In June 2011 the Human Rights Council unanimously endorsed a set of thirty-one Guiding Principles (GPs) that I proposed, each with commentary elaborating its meaning and implications for law, policy and practice. They were developed through nearly fifty international consultations involving business, civil society, workers organizations and governments; voluminous research reports; and pilot projects. The GPs are the first authoritative guidance the United Nations has issued for States and business enterprises on their respective obligations in relation to business and human rights, and it marked the first time the UN human rights machinery "endorsed" a normative text on *any* subject that governments did not negotiate themselves. What accounts for this reception?

The GPs are based on the recognition that corporate conduct at the global level today is shaped by three distinct governance systems. The first is the traditional system of public law and governance, domestic and international. Important as it is, by itself it has been unable to do all the heavy lifting on this and many other global policy challenges. Indeed, formal State-based multilateralism has become harder, not easier, in the past decade. The second is a system of civil governance involving stakeholders affected by business enterprises and their representatives, employing various social compliance mechanisms such as advocacy campaigns, lawsuits and other forms of pressure, but also partnering with companies to induce positive change. The third is corporate governance, which internalizes elements of the other two as constraints, risks and opportunities. While the doctrine of separate legal personality may govern asset partitioning by multinational enterprises, risk management and the identification of strategic opportunities tend to be conducted on an enterprise-wide basis.

The process of developing the GPs involved participants from each of these governance systems; it was an instance of polycentric governance. The intellectual and policy challenge was to try to formulate an authoritative basis whereby the three forms of governance systems

become better aligned in relation to business and human rights, compensate for one another's shortcomings and begin to play mutually reinforcing roles, out of which cumulative change can evolve over time.

To foster that alignment I drew on the different discourses and rationales that reflect the different social roles the three governance systems play in regulating corporate conduct. Thus, for States the emphasis in the GPs is on the legal obligations they have under the international human rights regime to protect against human rights abuses by third parties, including business, as well as policy rationales that are consistent with, and supportive of, meeting those obligations. For businesses, beyond compliance with legal obligations, the GPs focus on the need to manage the risk of involvement in human rights abuses. For affected individuals and communities, the GPs stipulate ways for their further empowerment to realize their right to remedy.

Pulling these elements together, the GPs rest on three distinct – but what I hoped would become dynamically interrelated – pillars:

1 The State *duty to protect* against human rights abuses by third parties, including business, through appropriate policies, legislation, regulation and adjudication;
2 An independent corporate *responsibility to respect* human rights, which means that business enterprises should act with due diligence to avoid infringing on the rights of others and to address adverse impacts with which they are involved;
3 Greater access by victims to *effective remedy*, judicial and nonjudicial.

The GPs encompass all internationally recognized rights, and apply to all States and all business enterprises. They do not by themselves create new legally binding obligations for business, but derive their normative force through the strong endorsement by States and other key actors, including business itself.

The relatively swift and widespread uptake of the GPs is the direct result of the polycentric process whereby they were developed and endorsed by stakeholder groups and the Human Rights Council. Elements are being implemented by individual governments (through national action plans; their role in implementing the complaints procedure under the OECD Guidelines for Multinational Enterprises, which now recapitulate the GPs' formulation of the corporate responsibility to respect human rights virtually verbatim; and in other discrete legal and policy measures, including guidance that China has issued for the overseas operations of its mining companies); by the European Union (for example, through a new mandatory non-financial reporting requirement for multinationals domiciled in EU member States); the International Finance Corporation (through its revised sustainability framework and performance standards); ASEAN (whose Intergovernmental Commission on Human Rights is drawing on the GPs in its own work); the African Union (in relation to the Africa Mining Vision); the International Organization for Standardization (through ISO 26000, laying out social responsibility criteria for all organizations); and the Equator Principles Banks (which provide three-fourths of private international project financing). The General Assembly of the Organization of American States has endorsed the GPs. Ever-increasing numbers of companies report that they are bringing their internal management and oversight systems into greater alignment with the GPs. Workers organizations as well as global and local NGOs are using the GPs as legal and policy advocacy tools. The International Bar Association, UK Law Society and American Bar Association are promoting the GPs' incorporation into the legal profession, including through law firms' client advisory work. These are but the most visible examples; others undoubtedly exist.

The two component elements of the GPs that have enjoyed the most rapid uptake are human rights due diligence by companies, and expanding the role of nonjudicial grievance mechanisms, including at the operational or site level established by or otherwise involving companies. The reason is simple. At least in principle, each of the three main stakeholder groups has an interest in making these provisions work, even though their rationales for doing so may differ. For States, promoting or requiring human rights due diligence and grievance mechanisms by multinationals serves the duty to protect; for firms, they are a means to manage stakeholder-related risk; and for affected individuals and communities they offer the prospect of reducing the incidence of corporate-related harm while also serving as one possible source of remedy where it occurs. I expect this kind of dynamic interaction to continue to drive change.

In sum, the GPs illustrate both the concept and the process of polycentric governance, as well as providing another example of micro-devices intended to have multinational enterprises take into account and manage their actual and potential human rights harm. They have triggered a wide range of cascading effects, including in the domain of hard law.

A core argument advanced in this book is that conventional social science understandings of both constitutionalism and of the multinational enterprise are inadequate to fully grasp the ongoing transformation in global governance, and that traditional modes of global governance are inadequate to meeting pressing people and planet challenges. All need to be reimagined and new approaches developed through informed practice. No comprehensive – let alone final – word is possible at this time about how to do that. Nevertheless, the authors advance the agenda enormously by pointing in, and exploring, promising intellectual and policy directions.

John Gerard Ruggie