

Project Financing in Developing Countries, New Corporate Social Responsibility, Human Rights, and Multinationals

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Economic development requires substantial investment in industry and infrastructure, much of which comes from outside the developing world. The outsiders can include international financial institutions and foreign governments, as well as private companies. These agents have different interests and run different risks in financing or operating infrastructure. To reduce or minimise the economic risks in particular, private companies often make use of project finance.¹

In a project finance scheme, a legally-independent project company, usually one that builds, or builds and operates, an industrial plant or a piece of infrastructure, is established by other pre-existing and usually very large multinational companies in commercial sectors related to that of the project company. These enterprises invest as shareholders in the project company and are called *sponsors* of the project company. Crucially, the project company also relies heavily on loans from banks to get established. These loans supply the bulk of the capital for the project company,² are often for extremely large amounts even by the standards of big business, and are secured against the future revenues of the finished project, *not* against the assets of the sponsors.³ For example, the oil multinational BP, sometimes with partners, is a sponsor of certain pipeline projects in various parts of the world. If the project company runs into difficulty servicing its debt, lenders have no claims on BP's assets - project funding is 'non-recourse' - but BP's shareholding will decline in value. So while BP and sponsors in general run risks in project finance, the risks arising from unpaid debt are mainly borne by private and public sector banks. Since project companies are largely financed from bank loans, the risks of unpaid debts can be significant. Private banks run these risks on the condition that they are *senior lenders*: they are first in the queue for project revenues, and also for the proceeds of asset sales for project companies that default on loans.

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¹ For a general introduction to the subject, see S. Hoffman, *The Law and Business of International Project Finance*, Second Edition (Ardsey, NY: Transnational Publishers, 2001). See also B. Esty and A. Sesia, '*An Overview of Project Finance - 2004 Update*' (Cambridge, MA: Harvard Business School, 2005), Case Note 9-205-605.

² In Esty and Sesia's overview, exhibit 1, bank loans account for 70 per cent of a typical project financing, with 30 per cent coming from sponsors.

³ The fact that sponsor assets are shielded from creditors is what distinguishes project financing from many other kinds of financing.

Governments of developing countries are often parties to project finance agreements.⁴ For example, they may run a tendering process culminating in agreements from sponsors to build or operate or build and operate an industrial unit or piece of infrastructure for decades. Governments also sign implementation agreements with sponsors,⁵ providing guarantees about the security of project facilities, as well as financial and other assurances. In order to secure investment, these governments may not only agree to buy the hydroelectric power that a dam produces, or to lease a telephone network; they sometimes also undertake in advance - by agreeing to the content of so-called stabilization clauses - to bear costs arising from any changes in local laws that have an economic impact on the project.

The relevant laws may be sensitive to economic, social, and cultural rights. For example, legislation protecting indigenous peoples' property rights or employment legislation can raise the costs of projects, and yet such legislation may not have been in place when the project started. For governments of poor countries to agree to relieve project companies of these costs may appear morally questionable. After all, the projects are often sponsored by rich companies which, it appears, can afford to pay, and which will make profits from the project anyway, sometimes very large profits. If the very large profits are made as large as they are through an agreement made by a poor host government, then the poor seem to be subsidising the rich. Again, where the legislation that raises costs is introduced to meet the needs of the very badly off, as opposed to the domestic ruling elite, there is arguably a moral obligation *anyway* on rich companies operating locally, as well as the rich part of the international community, to bear some of whatever burden that, say, the protection of indigenous people or employment rights require. This is the burden that project finance agreements appear to transfer back to struggling local governments.

Project finance is not well understood by human rights specialists, and it has so far received attention mainly because of the way stabilization clauses in host government agreements impede governments in carrying out their responsibilities under the main human rights treaties.⁶ I intend to approach project finance in a different way. I want to focus upon it as an area of commercial activity which has a significant impact on development, and on the human rights obligations connected with development. I also want to focus on it as a kind of commercial activity in which companies' 'spheres of influence', the areas in which they can be expected to exercise influence on other companies and host governments or human rights purposes, are particularly well defined. Human rights responsibilities are supposed to be exercised by companies within their 'spheres of influence' under both the Global Compact and the ill-fated UN Norms. But only in project finance, where contracts make explicit the relevant commercial relationships in great detail, is the 'sphere of influence' relatively precise.

⁴ As are governments of developed countries with respect to projects in developed countries. So-called public-private partnerships, pioneered in the early 1990s in the UK, have been taken forward with mixed results throughout the world. Although these partnerships also raise ethical issues, they are distinct from issues raised by project finance in developing countries, and will not be discussed here.

⁵ See Hoffman, n. 2 above, ch. 14.

⁶ *Human Rights on the Line* (London: Amnesty UK Business Section, 2003), at 33. <http://66.102.9.104/search?q=cache:2hU1CUzbRKYJ:www.amnestyusa.org/business/humanrightsontheline.pdf+Human+Rights+on+the+Line&hl=en&gl=uk&ct=clnk&cd=1>. *Contracting Out of Human Rights: The Chad-Cameroon Pipeline Project* (London: Amnesty International, 2005), at 29.

Old versus New Corporate Social Responsibility

In order to locate project finance within the context of the responsibilities of multinationals, we need to distinguish old from new corporate social responsibility. What we can call 'old' corporate responsibility is philanthropic activity voluntarily undertaken by the owners or management of a big business. There are countless examples of this, primarily in North America, but also in Western Europe. For example, the UK-based glass-making multinational, Pilkington, used to fund a whole range of social and sports facilities in its company town of St Helens, near Liverpool.⁷ The UK chocolate maker Cadbury and the home-products firm Unilever built whole new towns for their workforces in Bournville⁸ and Port Sunlight⁹ respectively in the 19th and 20th centuries. In the United States, the 3M company is a good example of a large industrial enterprise with an elaborate, long-established, entirely voluntary system of financial donation. Then there are the foundations of the super rich: Bill Gates, the founder of Microsoft, and George Soros, whose fortune is based on success in financial and commodities markets.

The old corporate social responsibility, apart from being voluntary, typically reflects the values of individual owners or managements, or a company tradition. If a company passes from one owner to another, corporate social responsibility can begin to be exercised in a different way, or not at all. Corporate financial contributions can suddenly shrink or disappear, and different good causes or none can begin to be supported. Under its present ownership and management Pilkington is less philanthropic than it used to be, for example, and the projects that 3M supports now are different from projects it has supported in the past.

What can be called 'new corporate social responsibility' is quite different from the old. It is multinational rather than national or local, and its presiding values are not taken from the religious or other values of a particular businessman or family, but from international law and human rights. Under the new corporate social responsibility, companies subscribe to a common set of international principles, and, what is considerably more, a common set of international standards that in some form or other bind governments. To a far greater extent than the old corporate social responsibility, the new acknowledges the widely perceived emergence of multinationals as agents with power comparable to that of states in the current world order. The new corporate social responsibility also acknowledges human rights standards as the common moral currency of international big business.

Two examples of companies that exercise the new corporate social responsibility are Statoil, a Norwegian oil and gas multinational, and the Swiss pharmaceuticals company, Novartis. Statoil not only adopts the Universal Declaration of Human Rights as informing its business principles, but proclaims that respect for human rights is integral to its corporate values.¹⁰ Novartis, similarly, explicitly declares support for human rights.¹¹ Both Statoil and Novartis are corporate members of the Business

⁷ For some of the background from an earlier phase of Pilkington's activities, see my 'Strategy and Ethics: Pilkington PLC' in D. Asch and C. Bowman (eds.), *Readings in Strategic Management* (London: Macmillan, 1989), at 280-90. For the current position, see <http://www.pilkington.com/about+pilkington/social+responsibility/default.htm>

⁸ http://www.cadbury.co.uk/EN/CTB2003/about_chocolate/history_cadbury/social_pioneers/bournville_village.htm

⁹ <http://www.portsunlightvillage.com/page.asp?pageid=history>

¹⁰ <http://www.statoil.com/STATOILCOM/SVG00990.NSF?opendatabase&lang=en&artid=347D0AF57DA2CEBAC1256E6900410B74>

¹¹ <http://www.novartis.com/about-novartis/corporate-citizenship/managing-cc/index.shtml>

Leaders' Initiative on Human Rights (BLIHR), which brings together the most prominent practitioners of the new corporate social responsibility.¹²

Although support for human rights standards and principles is a condition of much larger business groupings than BLIHR, it is rarely demonstrated in the kind of activism associated with BLIHR members. For example, the so-called Global Compact is an association of thousands of companies globally in support of human rights, but membership within the Global Compact does not always have a conspicuous impact in corporate practice. Instead, the Global Compact creates links between various UN agencies - including several concerned with human rights - and networks that encourage, rather than force, companies throughout the world to incorporate human rights, environmental and anti-corruption principles into accepted business practice.¹³

BLIHR stands to the Global Compact as good practice stands to common practice. BLIHR members actually implement, or try to implement, the principles that the Global Compact pays lip service to. The first principle of the Global Compact is to respect and protect human rights.¹⁴ This means not only not violating human rights, but more: 'As part of its commitment to the Global Compact, the business community has a responsibility to uphold human rights both in the workplace and more broadly within its sphere of influence.'¹⁵

The clear implication of this principle is that the influence of a company can extend outside its workplaces to sources of political power in its general operating environment. Especially in the developing world, multinationals have good access to governments and influence with officials. If this influence can be brought to bear in a kind of corporate diplomacy, then, according to the first principle of the Global Compact, it ought to be. BLIHR members, both in their individual corporate environments and collectively through BLIHR, associate themselves with the worldwide human rights movement. There is less evidence that the thousands of members of the Global Compact collectively do as much, and some reason to think that membership of the Global Compact by itself is supposed to be an act of human rights protection.

Sponsors and the Influence of Private Banks Subscribing to the Equator Principles

It is not just by declaring allegiance to them that multinationals engage human rights standards and enforcement. Human rights standards apply also as conditions of loans from international financial institutions, such as the World Bank. Then there are the scruples of *private* banks, which have sometimes evolved as the result of NGO criticism. These scruples have come to the fore in the recently formulated Equator Principles.¹⁶ They particularly apply to multinationals seeking loans for project finance.

The Equator Principles¹⁷ were put forward in 2003 by ten major banks¹⁸ involved in project finance. These principles were supposed to articulate loan conditions that would help to protect the environment and communities affected by infrastructure and

¹² <http://www.blihr.org/>

¹³ <http://www.unglobalcompact.org/AboutTheGC/index.html>

¹⁴ <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle1.html>

¹⁵ Ibid.

¹⁶ This section is heavily indebted to B. Esty, C.-I. Knoop, and A. Sesia, *The Equator Principles: An Industry Approach to Managing Environmental and Social Risks* (Cambridge, MA: Harvard Business School, 2005), Case Note 9-205-114, at 21.

¹⁷ <http://www.equator-principles.com/principles.shtml>

¹⁸ In order of ranking as arranger of project financing: Citigroup, Royal Bank of Scotland, WestLB, Barclays, HypoVereinsbank, ABN Amro, Credit Lyonnais, Credit Suisse First Boston, Westpac, and Rabobank.

industrial projects. Starting from the environmental and social risk classification system of the International Finance Corporation (IFC), the Equator banks distinguish between high and medium risk projects costing over \$50 million, and ask the relevant borrowers to prepare Environmental Assessment Reports and Environmental Management Plans, in consultation with parties affected by the project in the host country. Compliance with these plans has to be monitored independently. It is true that the the IFC safeguard policies that inspired the Equator Principles are not always strictly speaking human rights policies, they *are* concerned with things that come under human rights law, namely: indigenous peoples' rights, involuntary resettlement, cultural property, child labour, and forced labour.¹⁹ The effect of the Equator Principle borrowing conditions is to put plans in place for environmental and social responsibility lasting the life of a project.

Although the Equator Principles do not govern loans from many, let alone all, banks involved in project finance, they do involve some of the larger ones, notably Citigroup. So the sensitivities that the principles enforce are not those of a fringe banking sector. Again, as the International Finance Corporation is itself a major partner in project finance, and one of the World Bank group, even the non–Equator banks have to take into account its standards, if they are to participate in some projects supported by international public sector finance. In this way, an environmentally and socially responsible *avant-garde* in the public and private banking sector can exercise influence on the mainstream, not just in the banking sector, but in industrial companies acting as sponsors to project finance.

Sponsors' Responsibilities as Multinational Companies: The Implications of the UN Norms

We have seen that, through the pressure of banks, sponsors without corporate human rights policies of their own sometimes have to adapt their plans to reflect human rights sensitivities. Where does this leave sponsors involved in projects with banks that do *not* subscribe to the Equator Principles, and international financial institutions that do not press human rights requirements? Are sponsors of this sort free of human rights obligations? According to some human-rights respecting companies and NGOs, many transnational companies have moral and soft-law responsibilities for human rights, either under Organization for Economic Co-operation and Development (OECD) guidelines,²⁰ or under the recently formulated UN Norms.²¹ If this alliance of companies and NGOs is right, it follows that many sponsors in project finance agreements have human rights obligations, no matter who their bankers are, and no matter whether they have endorsed the Universal Declaration of Human Rights as corporations.

I do not propose to consider the OECD guidelines, as they are merely recommendations and do not cover sponsors from non-OECD countries operating outside the OECD.²² As for the UN Norms, I have expressed doubts about their applicability in full to any but a small *avant-garde* among multinationals.²³ So I dispute the premise of the argument made by some human-rights respecting companies and NGOs. But there is something in the conclusion of the argument. That is, it seems to me that

¹⁹ See n. 17 above, at 7n (d).

²⁰ *OECD Guidelines for Multinational Enterprises* (2000) http://www.oecd.org/document/28/0,2340,en_2649_34889_2397532_1_1_1_1,00.html

²¹ *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights* (2003) <http://www1.umn.edu/humanrts/links/norms-Aug2003.html>

²² They would probably not apply to Petronas, one of the sponsors of the Chad-Cameroon pipeline, for example.

²³ T. Sorell, 'The UN Norms' in J.Dine and A. Fagan (eds.), *Human Rights and Capitalism* (Cheltenham: Edward Elgar, 2006), at 284-299.

many sponsors in project finance deals, and *all* sponsors in project finance deals in developing countries, *do* have moral obligations, and perhaps legal human rights obligations; but this is not because they are multinationals, and all multinationals have human rights obligations wherever they operate. It is because of general facts about project finance in developing countries.

After indicating what the Norms say in relation to development, I will try to give reasons why project finance activity by sponsors in developing countries often seems to bring with it human rights obligations. Indeed, project finance activity seems a much more promising area for the articulation of plausible human rights requirements than the much broader area of multinational activity. In particular, project finance seems to give clear application to concepts in the UN Norms that become fuzzy when made to apply to transnational corporate activity of all kinds.

The paragraph of the Norms that comes closest to summarizing all of the rest, in my view, is the first:

1. States have the primary responsibility to promote, secure the fulfilment of, respect, ensure respect of and protect human rights recognized in international as well as national law, including ensuring that transnational corporations and other business enterprises respect human rights. Within their respective spheres of activity and influence, transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of and protect human rights recognized in international as well as national law, including the rights and interests of indigenous peoples and other vulnerable groups.

The Norms are an attempt to get transnationals to support or prompt action by states to fulfil human rights obligations. They are also an attempt to get transnationals to do things in their own right that promote some of the goals that human rights law promotes. It is not too much to say that the Norms are a sort of proto-treaty for multinationals, one that even anticipates a reporting system. The Universal Declaration of Human Rights already long ago urged the recognition and protection of human rights on all organs of society: the Norms spell out what transnationals can do, considered as organs of society, in view of their considerable capacity for aiding those who have primary responsibility for human rights.

The Norms emphasise development, and especially economic and social rights, as well as civil and political rights. Paragraph 12, which has more to say about human rights than any other part of the Norms, reads as follows:

12. Transnational corporations and other business enterprises shall respect economic, social and cultural rights as well as civil and political rights and contribute to their realization, in particular the rights to development, adequate food and drinking water, the highest attainable standard of physical and mental health, adequate housing, privacy, education, freedom of thought, conscience, and religion and freedom of opinion and expression, and shall refrain from actions which obstruct or impede the realization of those rights.

Now respecting the rights on this list, or refraining from doing things that obstruct the realization of these rights, requires less than seeing that they are respected, or protecting them, and the corresponding obligations are weaker than the obligation to intervene in, or at least protest at, for example, torture. It is true that Paragraph 12 goes beyond respecting and not violating rights, calling upon multinationals also to contribute to the realization of a whole range of rights. In this case what it asks for is arguably too much, especially where the multinationals being addressed have modest resources and no

tradition of corporate social responsibility. But, on the whole, what Paragraph 12 requires is modest, and is well within the capacity of most multinationals to comply with.

To see this, let us confine ourselves to the - for us - central case of a transnational company from a developed country deciding to operate in one of the less developed or even least well developed countries. For a company to decide responsibly to go into such a country is for it to decide on the fullest information about the country. Information about the respect of the relevant government for international legal standards will be relevant to whether the company can operate there commercially at all. Such information will also be relevant to considerations as to whether its equipment and cash reserves are secure, and whether employees it is bringing in and for which it is responsible will be safe. But a fully informed decision to go in will also take into account information - about the educational standards of the potential work force, local rates of pay, facilities for education and health - from which a range of *vulnerabilities* of local people can readily be inferred.

In a standard developing country, it can be inferred that people will have a relatively poor life-expectancy, and relatively poor access to medical treatment, schooling, good housing and most of the other necessities of a decent life. It is the fact that information about these vulnerabilities is an inevitable by-product of a reasonable *commercial* decision to go in that establishes a presumption that transnationals will operate so as not to turn vulnerabilities into actual harms. Even when faced with actual harms or rights violations that are not of its own making, a company does not necessarily exceed its responsibilities if it steps in. On the contrary, the poorer or less developed the country in which it operates, the less expensive the action it is asked to take, and the easier the action it is asked to take, the more inexcusable total inaction is.

The Special Responsibilities of Sponsors in Project Finance

Now if all of this can be said for multinationals in general operating in developing countries, consider the extra force of moral obligations like those stated in Paragraph 12 of the Norms when applied to sponsors in project finance schemes in developing countries. The crucial point about these sponsors is that they are not merely *present* in developing countries, but are *agents of development* in developing countries to a far greater degree than some other multinationals. This is partly because project finance schemes typically create the sort of infrastructure and industrial units that all or most other enterprises depend upon. What is more, the sponsors of project finance schemes are *self-consciously* involved in economic development schemes: the tenders they bid for make it explicit; the international financial institutions they deal with are development banks; and the complexities of carrying the projects to completion are largely complexities that result from what does not already exist and function in a developing country: roads; telecommunications; power; skilled manpower, and so on. Again, and now to take up what is right in some NGOs' emphasis on host government agreements, sponsors have to engage directly with, and sign covenants, with governments. These include governments that sponsors know are states-parties to human rights covenants. In other kinds of commercial activity - joint ventures with a local company, say, or the establishment of a subsidiary - the relationship with a government will not necessarily be this direct. Still less will the commercial activity be as conspicuously a part of an official development effort.

At the risk of labouring the point, let me illustrate the difference between being merely present as an economic agent in a developing country and being in a developing

country as an agent of development. The French retailing multinational Carrefour²⁴ operates in China, Colombia, Indonesia and Malaysia, places which also attract project finance activity. The form its presence takes is supermarkets. Retailing is far from insignificant as an economic activity, but at the level of sophistication of Carrefour it requires a well-established food distribution system, which in turn requires good roads, electricity, refrigeration, and many other things, some of which are typically provided by project finance schemes. Carrefour has no operations in Africa - which distinguishes it from multinationals in the extraction, construction and general industrial sectors. What holds for Carrefour probably holds for other multinationals, such as rent-a-car companies, airlines, or fast-food franchises, that are present in developing countries but not in the least developed ones. It is as if they come into their own only after other companies, infrastructure-building companies in particular, have done their work. These last are agents of development *par excellence*, or maybe better, *first movers* in development. Their ethical responsibilities may correspondingly be weightier than those of other companies.

So much for Paragraph 12 of the Norms, and its human rights obligations. I have been arguing that some of these obligations are weaker than others, but that sponsors involved in project finance are routinely, and properly, held to even the weaker of these obligations. They go with the territory.

Even when the Norms stray into requirements that it is hard to see as obligatory at all, either because most transnationals are not equipped to comply, or because they make transnationals responsible for the actions of other autonomous companies, these requirements seem to make some sort of sense in the project finance context. For example, the Commentary on transnational obligations in respect of security of persons that accompanies the UN Norms requires suppliers and distributors, and parties to contracts with the transnational company, to be compliant with human rights standards, and it is far from clear how the actions of this potential multitude of agents could possibly be kept track of by even a large company. Because so much is governed by detailed contracts between many parties in project finance, however, and because banks often insist on monitors for social commitments, these expectations may not be entirely out of place when it comes to sponsors or project companies in the kinds of infrastructure or industrial schemes I have been emphasizing throughout. Something similar goes for provisions for compensation in Paragraph 18 of the Norms. However excessive these seem to be when applied to just any multinational, they do not seem excessive in project finance situations in the developing world, where very vulnerable people are at the mercy of very large-scale, very disruptive commercial operations

Legal Obligations? The Applicability of the Norms to Sponsors as Opposed to All Multinationals

The Norms state obligations that I have been arguing are real *moral* obligations. But if they state *legal* obligations under international human rights law at all, they seem to be soft-law obligations, without real connections to established treaty and monitoring bodies. Since the Norms were adopted by the UN Subcommission on the Promotion and Protection of Human Rights in 2003, the UN Secretary-General has appointed a Special Representative, John Ruggie, to take further the question of how to connect human rights law with the transnational business sector.

Ruggie's Interim Report²⁵ seems to express scepticism about claims in the Norms²⁶ about the binding nature of human rights law on companies. Although the

²⁴ <http://www.carrefour.com/english/groupecarrefour/presenceMondiale.jsp>

²⁵ <http://www1.umn.edu/humanrts/business/RuggieReport2006.html>

report concedes that there is an emerging customary law tradition of holding transnationals to account under domestic law in developed countries, relevant cases often have to pass quite stringent tests for what counts as a human rights violation. Ruggie sees little prospect of bringing supposed corporate human rights violations under the UN system. It is more realistic, he thinks, for the jurisdiction of domestic courts in developed countries to be extended to cover the international activities of transnationals headquartered there.²⁷

One of the things Ruggie objects to in the Norms is its adoption of the language of an earlier voluntary human rights regime, the Global Compact. The Global Compact talks fairly loosely about the spheres of activity or spheres of influence of transnationals, taking these to extend beyond their own factories or offices. Under the Global Compact, participating companies are urged to bring their good offices to bear to protect human rights, even where this means speaking to governments and stepping outside their normal commercial networks. Ruggie rightly wonders how spheres of activity are to be mapped, how they are to be understood across commercial sectors, and how responsibilities for human rights can systematically be divided between companies and states. His points are well taken, since spheres of activity are bound to vary according to the commercial sector a company belongs to, the number of countries it operates in, the degree of development of those countries, and according to how a company balances commercial objectives with others. Within multinational activity concerned with project finance, however, the value systems that are growing up alongside some partnerships in investment, and in environmental and social plans associated with projects over long periods, seem both to define spheres of action better than in other sectors, and to enlarge them beyond the balance sheet or a single dam site or pipeline route.

Perhaps human rights standards for transnationals in general become controversial because they are formulated for too *many* companies and too *many* commercial environments all at once. Norms that worked for project finance would address the multinational activity that matters most to those with the least human rights protections. Norms for every country and every company may not only be harder to arrive at; they may be morally less important to arrive at.

²⁶ Ibid., see paras. 56-59

²⁷ Ibid., para. 71