Parental responsibility

Sustainable capitalism cannot afford irresponsible parent companies, argues **Charles Demoulin**

The *raison d'être* of capitalism is no longer to make as much money as possible as quickly as possible, without a care for the (long-term) costs and consequences imposed on the broader community and its environment. Capitalism must become more inclusive and respectful of other interests, including those of the generations to come. Capitalists who deny this urgent necessity are sawing the very branch they are sitting on.

Private corporations are expected to participate actively in this reinvention of capitalism, and institutional investors are supporting this evolution. Indeed, their investment decisions and stewardship activities reflect their focus on the long-term, sustainable development of the corporations in which they invest, and their impact on the broader environment. These priorities are in line with the investors' fiduciary duties towards their own beneficiaries (that is, you and me).

While the ranks of sustainable capitalists keep growing, there are still corporations that may prefer to disregard – intentionally or not – the interests of stakeholders. This can be more pronounced in the case of a corporation's subsidiaries in other jurisdictions. Indeed, there are still corporations that will try to take advantage of less demanding legislation, less efficient judicial systems, or even more complacent authorities in the countries in which their subsidiaries operate.

When parent corporations adopt that approach, they may feel somewhat protected from the legal and financial consequences of their subsidiary's misbehaviour abroad, due to the corporate rule of limited liability. This states that a shareholder's liability for a corporation's debts is limited to the former's investment in the capital of the latter. The rule has been extended to corporations acting as the shareholders of other corporations, and it has facilitated the structure and organisation of multinationals. In particular, given the rule of limited liability, those harmed by a subsidiary's operations have no other option but to litigate against that subsidiary before local courts. Those claimants risk being confronted by the subsidiary's insufficient resources, or any difficulties in accessing an efficient court system.

One possible solution to avoid this kind of unfair situation lies in making the parent company (also) directly liable for the harm resulting from its subsidiary's misconduct. Some recent case law from different jurisdictions hint at progress in that respect, and parent companies could potentially be held liable for the misconduct of subsidiaries in other jurisdictions.

PARENT COMPANY LIABILITY: UK AND CANADIAN DECISIONS

The increasing awareness of a parent company's potential liability for its subsidiary's misconduct was amply illustrated by two judgments from the UK Supreme Court in *Vedanta Resources Plc and Konkola Copper Mines Plc (Appellants) v Lungowe and Ors*, and *Okpabi and Others v Royal Dutch Shell plc and Another*. In both instances, the court dealt only with preliminary jurisdiction issues (can a UK-domiciled parent company serve as the anchor defendant to claim against its foreign-based subsidiary before the UK courts?) and the cases revolved around the issue of whether the claimants had a 'real triable issue' against the parent company. However, the court still provided useful guidance on the circumstances in which a parent company could be held liable for harm caused by a subsidiary overseas.

In *Vedanta*, a group of Zambian villagers brought a claim in common law negligence and breach of statutory duty against a UK company, Vedanta Resources Plc, and its Zambian subsidiary. This related to personal injury and damage arising from water pollution caused by the subsidiary's mining operation in Zambia.

Lord Briggs delivered the Supreme Court's unanimous judgment, which rejected Vedanta's contention that the claim against the parent company would involve a novel and controversial extension of the boundaries of the tort of negligence. Lord Briggs noted that 'the liability of parent companies in relation to the activities of their subsidiaries is not, of itself, a distinct category of liability in common law negligence... Everything depends on the extent to which, and the way in which, the parent availed itself of the opportunity to take over, intervene in, control, supervise or advise the management of the relevant operations (including land use) of the subsidiary.'

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He added that 'even where group-wide policies do not of themselves give rise to such a duty of care to third parties, they may do so if the parent does not merely proclaim them, but takes active steps, by training, supervision and enforcement, to see that they are implemented by relevant subsidiaries. Similarly, it seems to me that the parent may incur the relevant responsibility to third parties if, in published materials, it holds itself out as exercising that degree of supervision and control of its subsidiaries, even if it does not in fact do so. In such circumstances its very omission may constitute the abdication of a responsibility which it has publicly undertaken.'

The Supreme Court found that it was well arguable that a sufficient level of intervention by Vedanta in the conduct of the mine's operations may have been demonstrable at trial. In January 2021, the parties involved in the *Vedanta* litigation announced that they had reached a settlement.

Less than two years after the *Vedanta* decision, the UK Supreme Court issued another decision on a similar matter. In the *Okpabi* case, members of two Nigerian communities brought a claim in England against the UK company Royal Dutch Shell Plc and its Nigerian subsidiary Shell Petroleum Development Company for compensation for the harm caused by oil pollution. Again, the court was only dealing with a threshold question (whether there was a real issue to be tried), but it referred to its previous judgment in *Vedanta* and reaffirmed that parent company liability was not a distinct category and it 'raises

no novel issues of law and is to be determined on ordinary, general principles of the law of tort regarding the imposition of a duty of care'.

The court also rejected the idea that there was a limiting principle that 'the promulgation by a parent company of group wide policies or standards can never in itself give rise to a duty of care'. The court also found that the issue of control over the subsidiary 'is just a starting point. The issue is the extent to which the parent did take over or share with the subsidiary the management of the relevant activity (here the pipeline operation). That may or may not be demonstrated by the parent controlling the subsidiary. In a sense, all parents control their subsidiaries. That control gives the parent the opportunity to get involved in management. But control of a company and de facto management of part of its activities are two different things. A subsidiary may maintain *de jure* control of its activities, but nonetheless delegate *de facto* management of part of them to emissaries of its parent.'

In both *Vedanta* and *Okpabi*, the court rejected the appeals filed by the corporate defendants, and both cases highlighted the potential for parent company liability for the actions of overseas subsidiaries. However, questions around parent company liability are not confined to the UK, and the Canadian Supreme Court also grappled with important issues around breaches of international law by a parent company in its February 2020 judgment in *Nevsun Resources Ltd v Araya*.

The claims against Nevsun Resources Ltd, a Canadian company with its head office in Vancouver, were brought by Eritrean workers making allegations of forced labour, slavery, cruel, inhuman or degrading treatment, and crimes against humanity. They had been forced to work in a mine in Eritrea owned and operated by a local corporation, Bisha Mining Share Company (BMSC), in which Nevsun held a 60% stake through its subsidiaries.

As with *Vedanta* and *Okpabi*, the Canadian Supreme Court was dealing with preliminary issues rather than the merits. Proceedings in the lower courts in British Columbia had already found that Nevsun exercised effective control over BMSC. However, the Supreme Court was looking at the question of whether a non-state actor can be held liable in Canada for its alleged breaches of international law abroad. By a majority, the Supreme Court found that an entity like Nevsun could be held liable for breaches of customary international law.

Writing for the majority, Justice Abella found that 'Canada has long followed the conventional path of automatically incorporating customary international law into domestic law via the doctrine of adoption, making it part of the common law of Canada in the absence of conflicting legislation.' She added that 'it is not "plain and obvious" that corporations today enjoy a blanket exclusion under customary international law from direct liability for violations of "obligatory, definable, and universal norms of international law", or indirect liability for their involvement in what Professor Clapham calls "complicity offenses"'.

A few months after the judgment of the Supreme Court, the claims were settled out of court.

COMPETITION LAW BREACH – THE EUROPEAN PRECEDENT

One particular area where parent company liability is clearly embedded is in European Union law in relation to infringements of competition law. In *Akzo vs Commission*, C-97/08, Judgment of 10 September 2009, 58, the European Court of Justice established that 'the conduct of a subsidiary may be imputed to the parent company in particular where, although having a separate legal personality, that subsidiary does not

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decide independently upon its own conduct on the market, but carries out, in all material respects, the instructions given to it by the parent company…, having regard in particular to the economic, organisational and legal links between those two legal entities'. In these circumstances, the parent company and its subsidiary constitute a 'single undertaking', and this 'enables the Commission to address a decision imposing fines to the parent company, without having to establish the personal involvement of the latter in the infringement'.

The court has added that 'in the specific case where a parent company has a 100% shareholding in a subsidiary which has infringed the Community competition rules, first, the parent company can exercise a decisive influence over the conduct of the subsidiary… and, second, there is a rebuttable presumption that the parent company does in fact exercise a decisive influence over the conduct of its subsidiary'.

This rebuttable presumption has been extended to situations where the parent company holds, directly or indirectly, almost all of the capital in a subsidiary that has committed an infringement, and also where the parent holds all the voting rights associated with the subsidiary's shares, because the parent company 'is, in that regard, in a similar situation to that of a company holding all or virtually all the capital of the subsidiary.' (*The Goldman Sachs Group Inc. v European Commission*, C-595/18, judgment of 27 January 2021, 35.)

Where the Commission cannot rely on the rebuttable presumption, for example if a parent company holds a majority stake, or even a minority stake (*Fuji Electric Co. Ltd v European Commission*, T-132/07, judgment of 12 July 2011, 183), or in the case of a joint venture, it will have to prove that the parent company exercises a decisive influence on the commercial policy of its subsidiary.

This case law was developed in the context of the public enforcement of competition law, that is, the imposition of fines by the European Commission. However, the European Court of Justice recently decided that the same reasoning applied to private actions for damages filed by victims of a breach of competition law.

In a judgment of 14 March 2019 (*Vantaan kaupunki vs Skanska Industrial Solutions Oy et al*, C-724/17, judgment of 14 March 2019, 32.), the European Court of Justice ruled that 'the entities which are required to compensate for the damage caused by a cartel or practice prohibited by Article 101 TFEU are the undertakings, within the meaning of that provision, which have participated in that cartel or that practice', and further added that 'the concept of "undertaking", within the meaning of Article 101 TFEU, which constitutes an autonomous concept of EU law, cannot have a different scope with regard to the imposition of fines by the Commission under Article 23(2) of Regulation No 1/2003 as compared with actions for damages for infringement of EU competition rules.'

This was recently reaffirmed by the court (*Sumal SL v Mercedes Benz Trucks España SL*, C-882/19, judgment of 6 October 2021, 34.) in a request for a preliminary ruling on whether it is possible for a victim of an anticompetitive practice seeking damages to invoke the liability of a subsidiary rather than the parent company (a form of 'downstream liability'). In its judgment, the court in Grand Chamber made it clear that 'the determination of the entity which is required to provide compensation for damage caused by an infringement of Article 101 TFEU is directly governed by EU law.' The court highlighted that 'EU competition law, in targeting the activities of undertakings, enshrines as the decisive criterion the existence of unity of conduct on the market,

without allowing the formal separation between various companies that results from their separate legal personalities to preclude such unity for the purposes of the application of the competition rules'.

This leads to the conclusion that 'the conduct of a subsidiary may be attributed to the parent company in particular where, although having a separate legal personality, that subsidiary does not determine independently its own conduct on the market, but essentially carries out the instructions given to it by the parent company, having regard especially to the economic, organisational and legal links between those two legal entities, with the result that, in such a situation, they form part of the same economic unit and, hence, form one and the same undertaking responsible for the conduct that constitutes an infringement'.

Regarding the issue of liability towards victims, this means that: 'In the context of an action for damages based on an infringement of Article 101 TFEU found by the Commission in a decision, a legal entity which is not designated in that decision as having committed the infringement of competition law may nevertheless be held liable on that basis due to conduct amounting to an infringement committed by another legal entity, where those two entities both form part of the same economic unit and thus constitute an undertaking which is the perpetrator of the infringement within the meaning of that Article 101 TFEU.'

Parent company liability in cases where human rights have been violated... will also complement the work of institutional investors, as it will create even more incentive for them to perform their stewardship duties

Those examples from the UK and Canadian Supreme Courts and from the European Court of Justice confirm that holding parent companies liable is neither inconceivable nor exceptional from a legal point of view. The contexts, legal foundations, and reasonings behind the decisions may be different, but there are also similarities between the approaches as the courts looked at how relationships between parent companies and subsidiaries are structured and organised. Holding parent companies liable (or finding such liability 'arguable') in circumstances as described in the cases commented on above is nothing more than readjusting the law to fit the economic reality of modern corporate groups.

NEXT STEP: A LEVEL PLAYING FIELD

While the decisions above were issued by the highest courts of countries or continents in which many multinationals are based, parent company liability should be more widely – globally – accepted to prevent groups from engaging in forum shopping with the aim of avoiding accountability. There is also a need for a level playing field to protect 'good corporate citizens' from unfair competition from other corporate groups that do not attach the same value to human rights and other fundamental rules.

The European Commission recently published its long-awaited proposal for a directive on corporate sustainability due diligence. The scope of this initiative covers, yet goes beyond, the relationship between parent companies and their (indirect) subsidiaries. The proposal imposes certain obligations for (very) large EU companies (and, to some extent, non-EU companies) 'with respect to their own operations, the operations of their subsidiaries, and the value chain operations carried out by entities with whom the company has an established business relationship' (Article 1.1.(a) of the proposed directive). The proposal also provides for civil liability where companies have failed to comply with their obligations under Articles 7 and 8 of the proposed directive to prevent potential adverse impacts, and to bring an end to actual adverse impacts (Article 22).

First reactions to the proposal from NGOs have not been enthusiastic. Many of them deplore the limited scope of the proposal (as it would only apply to 1% of EU companies), loopholes in the civil liability regime and the lack of victim-friendly mechanisms to help them enforce their rights (rules of evidence, limitation periods, etc.).

The legislative process has now started, and both the European Parliament and the Council of Ministers will be able to discuss and amend the Commission's proposal. We can only hope that the final text adopted by the European institutions will live up to expectations, including for businesses that want to contribute to a more sustainable economy but do not want to suffer from a competitive disadvantage.

Initiatives like the Commission's proposal to regulate this matter at European level, even though it still requires improvement, are an important first step. However, they must be replicated elsewhere and, ideally, harmonised to contribute to a global level playing field. Voluntary initiatives and soft law in these essential areas, both at national and international level, have shown their limits. Recent decisions issued by the jurisdictions such as the UK and Canadian Supreme Courts which lay the foundations of (international) parent company liability are welcome developments to correct some of these flaws. We now need a legal framework that is more broadly shared.

Parent company liability in cases where human rights have been violated, climate protection, and other regulations of general and public interest will also complement the work of institutional investors, as it will create even more incentive for them to perform their stewardship duties. Large investors will continue demanding assurances from the senior management of their portfolio companies that they will carefully monitor all activities at group level to prevent any wrongdoing that could lead to their liability. Such liability will, therefore, not only make it possible for victims to obtain compensation, but will also act as a powerful deterrent. That should convince all stakeholders, and not only corporate groups, of the concrete economic impact of complying with ESG standards on a global scale.

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