EW Barker Centre for Law & Business
Faculty of Law

NUS EW Barker Centre for Law & Business Working Paper 23/01

NUS Law Working Paper 2023/007

Corporate Liability for Wrongdoing within (Foreign) Subsidiaries:

Mechanisms from Corporate Law, Tort and Regulation

Paul Davies

Visiting Professor, EW Barker Centre for Law and Business,

Faculty of Law, National University of Singapore

[Uploaded January 2023]

© Copyright is held by the author or authors of each working paper. No part of this paper may be republished, reprinted, or reproduced in any format without the permission of the paper's author or authors.

Note: The views expressed in each paper are those of the author or authors of the paper. They do not necessarily represent or reflect the views of the National University of Singapore.

CORPORATE LIABILITY FOR WRONGDOING WITHIN (FOREIGN) SUBSIDIARIES: MECHANISMS FROM CORPORATE LAW, TORT AND REGULATION

Paul Davies

Abstract

The liability of parent companies for wrongdoing within subsidiaries is an old topic. Modern discussions tend to extend the potential liability of the parent to wrongdoing within the whole supply chain (or, even, the value chain), thus embracing liability for the actions of contractors and sub-contractors. The legal mechanism at the centre of traditional discussion is piercing the veil of the subsidiary company – a mechanism not obviously apt for contractors. In any event, UK law set its face firmly against piercing the veil in *Adams v Cape Industries* (Court of Appeal, 1990), even though the claimants were tort victims and thus non-adjusting creditors.

Almost immediately thereafter, however, the UK courts began to develop a tort theory of parental liability for wrongdoing within subsidiaries. This was derived from the assertion of the relevant degree of managerial control over the subsidiary by the parent and so depended on the level of control exercised (or, perhaps, claimed by the parent) over the subsidiary's activities. Although initially developed in a purely domestic setting and where the main tortfeasor (the subsidiary) could not meet the claim upon it, the most recent cases have involved subsidiaries of multinational companies based in the developing countries where the subsidiary was not obviously unable to meet the claim upon it. The claimants' desire to sue the parent in the English courts was based on access to justice arguments. Although not so far extended in a judgement, this tort theory would appear to be available against contractors where the parent has exercised the relevant level of control over the contractor. But, liability for the actions of contractors has been established on the more limited theory of the creation by the defendant company of a "dangerous situation", which a third party exploits to the detriment of the claimants.

A second way around the absence of veil piercing is the imposition of a regulatory obligation upon parent companies to monitor compliance by subsidiaries (and contractors) with applicable obligations and to make parents liable if the compliance exercise is not properly carried out. This is the approach taken in the proposed EU Directive on Corporate Sustainability Due Diligence. In spite the width of the title, the Directive will cover only a set of international human rights and environmental conventions – though the set is large. The Directive requires large companies (defined by turnover levels), even if they are incorporated outside the EU but have the relevant level of intra-EU turnover. They must assess the risks of harm arising out of breaches of the international obligations throughout the supply chain; take steps to remove or reduce the risks so revealed (or which ought to have been revealed); and mitigate harms arising when breaches to occur. The company is liable to regulatory penalties

if it fails at any of these three stages and is liable to be sued by those who suffer actual harm as a result of the company's negligent non-compliance with its regulatory duties.

It is clear that this initiative of the EU is aimed principally at non-compliance occurring outside the EU within host states. I suggest that companies subject to the Directive will find themselves in a difficult place if non-compliance is a deliberate policy of the host state (which is not required to be a signatory of the relevant international treaty) or where the host state interprets the treaty obligation in a way not generally accepted by EU courts or regulators. The risk of reputational harm the parent may suffer as a result of an adverse judgment in the EU may cause the company to exit from the business in question by selling it to a competitor not subject to the EU rules. The result is not likely to be a higher level of compliance with the international standards, but only a contraction in the activities of EU companies.

The paper concludes with some reflections on the choice between tort and regulation in relation to the unintended consequences of parent company liability.

Key Words: Parent company liability; piercing the veil; tort theories of parental liability; regulatory compliance; host country policies.

Corporate Liability for Wrongdoing within (Foreign) Subsidiaries: Mechanisms from Corporate Law, Tort and Regulation

Paul Davies*

The extent to which parent companies should be liable for wrongdoing committed within their subsidiaries is a question to which much attention has been devoted within academic scholarship over the years, though, so far, with relatively little outcome in terms of the law on the books. The dominant rule is one of non-liability: victims of wrongdoing are confined to remedies against the particular company within which the wrongdoing occurred. However, there have always been exceptions to this position of non-liability of the parent and in recent years these exceptional cases have expanded their scope somewhat, and there are developments on foot which, if continued, would make the exceptions even more important. The purpose of this paper is to analyse the scope and rationale for the exceptions, predominantly in UK and EU law. The paper suggests that, doctrinally, the expanded scope of parent liability has involved a shift away from a corporate law analysis of the issue (the long-standing and intellectually unsatisfactory doctrine of piercing the corporate veil) to a tort analysis (now seen as a standard application of the tort of negligence) and, perhaps in the future, to a regulatory analysis, which requires companies to carry out a "due diligence" assessment of the more egregious risks associated with its businesses and makes them liable for harms resulting from inadequate due diligence exercises. This both the tort and, to an even greater extent, the regulatory approach tie parental liability back to company law, since they rely on a core corporate governance mechanism – the board of the parent company – as the basis for corporate liability (tort theory) or to discharge an expanded monitoring role (regulatory theory). Even the tort approach generates incentives for the board to define more precisely its monitoring role in relation to unlawful conduct by subsidiaries, as we shall see below.

I. The Issue in Corporate Law

There is probably no developed jurisdiction which does not attach separate legal personality to a business which incorporates under its general company law. The same statement may be made about limited liability, at least as a default rule. In the law and economics school of company law analysis, these two features are seen as together providing a core feature of the

company form, namely asset partitioning.[1] Under this view, it is a central feature of the company (and of some, but not all, other forms of business organisation provided by the law) that the business assets of the shareholders are strictly demarcated from their personal assets. This is achieved by allocating the business assets to the company (via its separate personality) and then hindering both the creditors of the company from attaching the shareholders' personal assets and the shareholders' creditors from attaching the assets of the company. Limited liability clearly hinders the company's creditors vis-à-vis the shareholders' assets, while the separate legal personality of the company hinders the shareholders' creditors vis-à-vis the company's assets. The advantages and disadvantages of limited liability are much debated in corporate law scholarship, but the majority view is that its advantages outweigh its disadvantages. Less often noticed, however, is the benefit of asset partitioning to corporate creditors (and others involved in the company). The shareholders' creditors may attach their debtors' shares, of course, but the company's assets cannot be touched, even in the case of a controlling shareholder, to the clear benefit of those (other shareholders, employees, consumers) who benefit from the company's continuation as an operating business.[2]

However, within the asset partitioning analysis, there is room for qualification of the conclusion that strict separation is always the most efficient position. Indeed, the very authors who are most closely associated with the asset partitioning analysis have suggested two cases where qualification would be beneficial. These are (a) where the creditors are tort victims (and, possibly, other "non-adjusting" creditors)[3] and (b) where it is sought to apply asset partitioning within groups of companies.[4] The first qualification is driven by a desire to control "externalities", ie costs of production which the company does not bear because those costs have been thrown onto others (without any explicit or implicit agreement that this transfer should occur). The consequence of externalities is that the company's goods or services are produced "too cheaply" and so "too much" of them is consumed. The classic case of an externality is environmental harm for which the company is not liable, either contractually or

* KC (hon), FBA. Allen & Overy Professor of Corporate Law Emeritus, University of Oxford; Senior Research Fellow, Commercial Law Centre, Harris Manchester College, Oxford; Visiting Professor, EW Barker Centre for Law and Business, January – February 2023.

[1] H Hansmann and R Kraakman, 'The Essential Role of Organizational Law' (2000-2001) 110 *Yale L J* 387.

[2] P Davies, *Introduction to Company Law* (OUP, 3rd ed, 2020) pp 6-9.

[3] H Hansmann and R Kraakman, 'Towards Unlimited Shareholder Liability for Corporate Torts' (1991) 100 *Yale L J* 1879.

[4] H Hansmann and R Squires, 'External and Internal Asset Partitioning: Corporations and their Subsidiaries' in J Gordon and W-G Ringe (eds), *Oxford Handbook of Corporate Law and Governance* (OUP, 2018).

under regulation, but tort victims whose claims exceed value of the company's assets fall into the same category.

Despite the support for this first qualification from the authors of the asset partitioning analysis, it has gained little traction in doctrinal reform in any jurisdiction I am aware of. Most probably this is due to the availability of a range of alternative, and arguably more effective, techniques for addressing this issue. Most prominent, perhaps, is mandatory insurance for those engaging in hazardous activities, a technique capable of embracing all those whose assets are likely to be insufficient to meet their liabilities. It is a mistake to think that the only tortfeasors at risk of being unable to meet in full a judgment against them are limited companies.

The second qualification stems from the broader view that most of the advantages claimed for asset partitioning do not exist within groups, either as a matter of logic or of intra-group practice.[5] For example, the benefits in terms of reduced monitoring of the wealth of fellow shareholders which shareholders of the parent company gain from the limited liability of that company are not enhanced by the limited liability of subsidiaries (at least where the subsidiaries are wholly owned), while other benefits are undermined in fact by the widespread practice of offering major creditors cross-company guarantees, ie limited liability is contracted out of pro tanto. Consequently, in relation to groups it is arguable that the costs of asset partitioning exceed its benefits. Perhaps for these reasons, the second qualification to strict asset partitioning has encountered a somewhat warmer welcome across jurisdictions. In courts this has normally taken the form of a greater willingness to apply the doctrine of veil piercing,[6] whilst at a legislative level some jurisdictions have adopted (or there have been proposed) more elaborate arrangements, normally involving some trade-off of parent company liability for subsidiaries' debts in exchange for greater formal control over the subsidiaries' decisions by the parent board.[7]

---

[5] Above n 4.

[6] Which is in fact the principal doctrinal recommendation of Hansmann and Squires, above n 4. Nevertheless, as a matter of current court practice, even in the US (generally regarded as more open to veil piercing than most others), veil piercing is not often used: Robert B. Thompson, 'Piercing the Corporate Veil: An Empirical Study', (1991) 76 *Cornell Law Review* 1036 and 'Piercing the Corporate Veil within Corporate Groups: Corporate Shareholders as Mere Investors', (1999) 13 *Connecticut Journal of International Law* 379. For other jurisdictions see Tan Cheng-Han, Jiangyu Wang, & Christian Hofmann, 'Piercing the Corporate Veil: Historical, Theoretical, and Comparative Perspectives' (2019) 16 *Berkeley Business Law Journal* 140.

[7] These arrangements have been reviewed, recently and somewhat sceptically, by L Enriques and S Gilotta, *The Case against a Special Regime for Intragroup Transactions*, Part IV (ECGI Law Working Paper 641/2022, May 2022). The best known example of this approach is German "group law", under which the parent is granted the

The UK legislature has joined in the general reluctance to impose liability upon shareholders for corporate torts where the company's assets are insufficient, but the courts have also rejected any special rule for qualifying limited liability within corporate groups. In *Adams v Cape Industries plc*[8] the Court of Appeal rejected a whole raft of arguments that might have led to the opposite result. There was "no general principle that all companies in a group of companies are to be regarded as one." The court had no jurisdiction to pierce the corporate veil within groups where the interests of justice so required. The fact that the parent had overall control of the subsidiary was not a basis for ignoring the separate legal personalities of the two companies. There was no presumption that the subsidiary was to be regarded as the agent of the parent/principal. Overall, "if a company chooses to arrange the affairs of its group in such a way that the business carried on in a particular foreign country is the business of its subsidiary and not its own, it is, in our judgement, entitled to do so."[9]

II. The Issue in Tort Law

However, *Adams* was by no means the end of the story. In a series of later decisions, sometimes involving the same company as in the *Adams* case, the courts made use of the law of tort to create a duty of care owed directly by the parent company to those harmed by the actions of its subsidiary, provided the parent exercised the required degree of managerial control over the subsidiary. These "parent control" cases are capable of generating a broad set of circumstances in which the parent will be liable for tortious conduct occurring within the subsidiary. Second, in a doctrinally separate development, the courts have expanded the exceptions to the general principle that there is no liability in tort for harm caused to others as a result of the intervention of a third party. In a corporate context, this is a narrower basis of liability than the managerial

freedom to direct the subsidiary's actions in exchange for indemnification of the subsidiary against losses thereby incurred. In the case of wholly-owned subsidiaries it is not clear that the parent obtains much benefit from such an arrangement, so long as the subsidiary is a going concern, and even when the subsidiary is in the vicinity of insolvency, doing what the parent requires is not always contrary to the interests of the subsidiary. See *Charterbridge Corporation v Lloyds Bank* [1970] Ch. 62.

[8] [1990] Ch 433, CA. In this case, a federal court in Texas had given judgement against, inter alia, the UK-incorporated parent. The parent had not defended the proceedings or otherwise submitted to the jurisdiction of the Texas court. The successful plaintiffs sought to enforce the Texas judgment against the parent in the UK. The enforceability of the judgement in the English courts turned on whether the parent was "present" in Texas, something which could be shown only by treating the parent as present via its US subsidiaries and affiliates, since the group had arranged its affairs so that the parent did not operate in the US.

[9] Subsequent decisions about veil piercing in free-standing companies have evinced no greater fondness for making exceptions to the general rule: *Prest v Petrodel Resources Ltd* [2013] UKSC 34.

control theory, but it has the capacity to operate not only in relation to harm caused by subsidiaries but also in relation to contractors.

A. The Managerial Control Theory

i. The Parent's Duty of Care Accepted in Principle

In *Chandler v Cape plc*[10] the Court of Appeal upheld Wyn Williams J's finding of liability in tort after a trial. Unlike the arguments for piercing the veil, which focus exclusively on the relationship between the parent and the subsidiary, the tort theory concentrates on the relationship between the parent and those who suffered harm. Indeed, it seems possible that the tort theory could result in liability for the parent, even when the subsidiary had committed no wrong against those who suffered harm, for example, where the subsidiary enjoyed some immunity against suit which the parent lacked or the risk in question was foreseeable only by the parent company. However, too much should not be made of this point. As we shall see below, the question of whether the parent owes a duty to those suffering harm turns in large part on the closeness of the control exercised by the parent over the subsidiary's activities. The correct analysis appears to be that the duty is owed in law by the parent to the claimant, but it arises out of an analysis of the degree of factual control exercised by the parent over the subsidiary in relation to the hazardous activities carried on within the subsidiary.

Because the "parent tort" theory is a theory of direct liability of the parent towards the claimants, not a theory of vicarious liability of the parent for the torts of the subsidiary, the central question becomes one of determining the situations in which the courts will recognise that the direct duty has arisen. Unlike with vicarious liability, where the liability of the principal/employer is automatic provided the relevant relationship exists, the direct liability of the parent does not flow automatically from the parent/subsidiary relationship.

ii. "Ordinary" Tort Law or Not?

In *Chandler*, apparently the first case in which liability was established on the basis of a duty of care owed by the parent to those who suffered harm as a result of the subsidiary's actions, the trial judge regarded himself as presented with a novel situation for the application of a tortious duty of care. He therefore directed himself according to the tripartite tests laid down in *Caparo Industries plc v Dickman*[11] for the recognition of a duty of care in situations not

[10] [2012] EWCA Civ 525, CA.

[11] [1990] BCLC 273, HL.

previously considered by the court. The same approach was followed by the Court of Appeal in that case. Of course, Lord Bridge had commented in *Caparo* that "the concepts of proximity and fairness embodied in these additional ingredients [additional to foreseeability] are not susceptible to any such precise definition as would be necessary to give them utility as practical tests" and are really conclusionary rather than analytical statements. Nevertheless, the fact that the courts in *Chandler* took them as the framework for analysis indicates that they regarded themselves as treading new ground, even though the harm at issue in *Chandler* was personal injury caused by physical means, a fact pattern hardly new to the law of tort, rather than economic loss caused by negligent misstatement, as in *Caparo*.

By the end of the last decade, however, the Supreme Court had decided that the courts no longer needed the *Caparo* check on their inventiveness. In *Vedanta Resources plc v Lungowe*[12] Lord Briggs said of the *Caparo* test that "it did not lead to the identification of a wider basis in law for the recognition of the relevant parental duty of care than that which in my view, the law actually provides, by reference to basic principle."[13] He approved the approach of Sales LJ (as he then was) in *AAA v Unilever plc*[14] who said: "There is no special doctrine in the law of tort of legal responsibility on the part of a parent company in relation to the activities of its subsidiary, vis-à-vis persons affected by those activities. . . The legal principles are the same as would apply to in relation to the question whether any third party (such as a consultant giving advice to the subsidiary) was subject to a duty of care in tort owed to a claimant dealing with the subsidiary."[15] To similar effect was the decision in *Okpabi v Royal Dutch Shell*: it was "not the correct approach" to focus on the three-fold test for a duty of care set out in *Caparo.*[16]

At one level, this development was to be expected. Once it was decided, on *Caparo* principles, that a duty of care could be owed by a parent company towards those harmed by the activities of a subsidiary, it was not helpful to recur constantly to those very imprecise criteria to establish the circumstances in which that duty would arise. To perform that second-stage task, the courts needed to move beyond the generalities of *Caparo* and focus directly on the characteristics of

[12] [2019] UKSC 20
[13] At [56].
[14] [2018] EWCA Civ 1532.
[15] At [36]. For an extension of this argument to the controlling shareholders of at least state-owned entities see E Lim, *Sustainability and Corporate Mechanisms in Asia* (CUP, 2020) 267-273.
[16] [2021] UKSC 3 at [24] - [25].

the parent/subsidiary relationships which would lead the courts to regard the imposition of a duty of care on the parent towards third parties as appropriate.

However, there appears to have been a second incentive for the courts to move in this direction. *Chandler* involved a UK subsidiary of the UK parent company. This was a classic case of the wrongdoing subsidiary not being worth suing, because its insurance policy for some reason failed to cover the risk of harm in question (pneumoconiosis caused by the inhalation of asbestos dust) or the particular class of claimant (who had not been employed directly in the part of the business which handled asbestos).[17] The subsequent cases, *Vedanta, AAA* and *Okpabi*, all involved foreign subsidiaries of an English parent company, which carried on substantial continuing businesses in their respective jurisdictions.[18] Although some doubts were expressed on this score, it was certainly never shown that the subsidiary would be incapable of meeting any judgement that might be made against it or that the parent would not support the subsidiary. The driving force behind the claimants' desire to sue in the English courts seems to have been what were referred to in the cases as "access to justice" arguments. In particular, the availability of funding and legal expertise to support large-scale litigation against a multinational company was, the claimants argued, substantially greater in the UK than in the subsidiaries' jurisdictions.[19] Although too polite to mention it, the claimants may have felt also that they would be likely to obtain a more open hearing in an English court, since in both the *Vedanta* and *Okpabi* cases the government in whose territory the operations were conducted had a substantial economic interest in the subsidiary, either directly or indirectly.[20]

In addition to the duty of care issue, there was therefore a jurisdictional issue. Since the harm had occurred outside the UK, were the English courts the appropriate forum to hear the claims? As the law then stood, this was not a serious issue in relation to the parent company, since the Brussels Regulation[21] had been interpreted by the CJEU as permitting only very narrow exceptions to the rule that companies domiciled in the EU may be sued in the jurisdiction of their domicile in respect of breaches of duty by them, no matter that the harm was inflicted

[17] The subsidiary in fact had been dissolved, but presumably it could have been restored to register, had its insurance policy been of any value.
[18] Zambia, Kenya and Nigeria, respectively.
[19] These issues did not relate only to the claimants' motivations to sue in the English courts but also the legal question of whether the English courts should take jurisdiction over the tort claim against the foreign subsidiary. See *Vedanta* at [66] to [87].
[20] See further below the discussion of host state involvement in human rights abuses.
[21] Art. 4 of the Recast Brussels Regulation on Jurisdiction etc in Civil and Commercial Matters, Regulation (EU) 1215/2012.

elsewhere.[22] However, in addition to the parent (the "anchor defendant"), the claimants also sought to sue in the English courts the subsidiaries directly responsible for the alleged harm. This was in all likelihood for the same reasons as motivated the litigation against the parent in the English courts, coupled with the desire to avoid the risk of inconsistent judgments if the subsidiary were sued in its operating jurisdiction and found not liable.

This put the claimants in the position of having to obtain the court's permission to serve legal process on the subsidiary out of the jurisdiction. In turn, this brought back centre stage the question of whether there was a triable issue against the parent, this being one of the tests to determine whether the subsidiary was a "necessary and proper party" to the litigation against the parent.[23] However, the courts were concerned to avoid extensive hearings at this preliminary stage. In both *Vedanta* and *Okpabi* the Supreme Court was clear that the parties had overstepped the line: the litigation over the preliminary jurisdiction issues had been "disproportionate" and had approached the "self-defeating" position that it was necessary to have a trial to determine whether a trial was necessary. In *Okpabi*, where the Supreme Court viewed the lower courts as having conducted a mini-trial, it was said that at the jurisdictional stage the focus should be on the particulars of claim and a decision made on the arguability point on the basis of the facts so alleged, without the defendant seeking to dispute the factual allegations with its own evidence, except in rare cases. Moving to the view that the parent's liability was a matter of ordinary tort law might be seen as further discouraging defendants from making elaborate arguments at a preliminary stage in the litigation that jurisdiction should be rejected.[24]

iii. What Does "Ordinary" Tort Law Require?

[22] The court in *Vedanta* discussed the CJEU jurisprudence at [23] to [41]. It rejected the defendants' argument that it was an abuse of EU law to use Art. 4 to establish jurisdiction against the parent for the sole purpose of establishing jurisdiction against foreign defendants who were the real objects of the claim. This argument failed largely on the facts, since the parent as well as the foreign subsidiary was a real object of the claims. For the possible resurgence of forum non conveniens issues in relation to parent companies post-Brexit, see E Aristova, 'The Future of Tort Litigation against Transnational Corporations in the English Courts: Is Forum [Non] Conveniens Back?' (2021) 6 *Business and Human Rights Journal* 399.

[23] CPR, Pt 6, Practice Direction 6B, para. 3.1.

[24] In *Vadenta* the defendants sought to argue that the court should not take jurisdiction over the subsidiary, inter alia, because 'this was no means a *Chandler* type of case' (at [49]), ie the very approach which was rejected by the Supreme Court in *Okpabi* (see text attached to n 16).

Although the most recent and authoritative decisions on the tort liability of parent companies concerned preliminary issues, it is now tolerably clear where the courts will focus their attention when determining whether the parent owed a duty of care to the claimants.[25] They will focus on the extent of the control of the parent over the subsidiary. It is equally clear that control here is not what a corporate lawyer understands by that term in the context of parent/subsidiary relationships. Under the Companies Act 2006 control is defined, principally, in terms of holding a majority of the voting rights of another company or having the right to appoint or remove the majority of its board of directors.[26] On the company law approach, therefore, a company would always have control of another majority- or wholly-owned company.

For the purposes of the duty of care in tort, by contrast, the capacity to control the actions of the subsidiary is not enough. The focus is on what might be termed "managerial" control. To what extent has the parent involved itself in the management of those aspects of the subsidiary's activities which are alleged to have generated the harm of which the claimants complain – or, possibly, has held itself out as being so involved? A company with control of another on the company law tests is not necessarily one with control on the tort tests. It may have the authority to exercise the tort level of control, but have decided not (or simply failed) to do so, presumably for commercial reasons related to its view of the benefits of leaving a high level of discretion to the subsidiary as to how it might best conduct its activities.

Although not to be treated as exhaustive, the Supreme Court in *Okpabi* regarded the decision in *Vedanta* as having identified at least four routes to managerial control of the subsidiary:

(1) The parent taking over the management or joint management of the relevant aspects of the subsidiary's activities;
(2) The parent providing defective advice or defective group-wide policies which the subsidiary implemented without further analysis;
(3) The parent promulgating group-wide policies and taking active steps to secure their implementation by subsidiaries;

[25] But it follows that the appeal courts have not yet addressed in any detail the questions of whether the duty of care was broken, whether it caused harm to the claimants and how compensation should be assessed.
[26] CA 2006, ss 1159 and 1162. For reasons related to EU law there are slightly different definitions for "holding" companies and "parent" companies, but the core of both definitions is as stated in the text.

(4) The parent holding out that it exercises a particular level of control over the subsidiary.[27]

In *Opkabi*[28] the court's view was that there was an arguable case under both headings (1) and (3). In *Vedenta*[29] the focus was primarily on (3).

At first sight, managerial control is a more difficult thing for claimants to demonstrate than corporate control. For share ownership, the data are publicly available, both for legal ownership (in all cases) and for beneficial ownership (in publicly traded companies at the 3% level and above and at the 25% level in nearly all cases).[30] Managerial control, by contrast, requires information about the internal arrangements of the group, a matter which traditionally has been regarded as of private business concern and so not subject to mandatory disclosure. However, there are at least two ways in which claimants may seek to address this difficulty. First, effective group-wide policies and their implementation are likely to require both internal administrative arrangements for the production of those policies and their dissemination to the relevant levels of parent and subsidiary management. The policies cannot be locked away in the CEO's safe if they are to have an impact nor the source of their authority be obscured; on the contrary, they will become available to a significant number of employees of the parent or subsidiary. In *Opkabi* the claimants relied on information provided by former employees of Shell as to both the administrative arrangements and the content of the policies.[31]

Second, over the course of this century, publicly traded companies have come under obligations to publish documents relating to matters which might have been regarded previously of only internal concern. Thus, under the Companies Act 2006 companies are required to produce as part of their annual accounts a "strategic" report, which in the case of "quoted"[32] UK companies, includes "non-financial" information on:

---

[27] This lists omits a possible further basis of liability identified in *Chandler*, ie superior knowledge. This arises where '(1) the businesses of the parent and subsidiary are in a relevant respect the same; (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary's system of work is unsafe as the parent company knew, or ought to have known; and (4) the parent knew or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employees' protection.' (at [80]).

[28] At [153].

[29] At [61].

[30] *Gower Principles of Modern Company Law* (Sweet & Maxwell, 11th ed, 2021) paras 27-011ff, 13-022ff and28-024 (this last dealing with the disclosure of "control arrangements").

[31] At [133] to [140].

[32] Ie officially listed in the UK or an EEA state or traded on the NYSE or Nasdaq.

- Environmental matters (including the impact of the company's activities on the environment)[33];
- The company's employees;
- Social matters;
- Respect for human rights
- Anti-corruption and bribery matters.

This information must include descriptions of the corporate policies or due diligence policies pursued in relation to these matters (or an explanation of why the company does not have policies on a particular matter), of the outcomes of these policies, of the risks the company faces in these areas which are likely to have an adverse impact and of how it manages these risks.[34] Reputational incentives are likely to encourage large publicly traded companies to adopt policies rather than report that it had no such policies.[35]

Consequently, there will be in the public domain a significant amount of material relating to the level of control exercised by parent companies over subsidiaries. So, in *Vedanta* Lord Briggs, whilst discounting the significance of a management services agreement between parent and subsidiary, concluded: "But I regard the published materials in which Vedanta may fairly be said to have asserted its own assumption of responsibility for the maintenance of proper standards of environmental control over the activities of its subsidiaries . . . and not merely to have laid down but also implemented those standards by training, monitoring and enforcement, as sufficient on their own to show that it is well arguable" that the parent exercised the requisite degree of control over the subsidiary.[36] In *Opkabi* the Court of Appeal, although, unlike the Supreme Court, finding in favour of Shell, held that the first instance judge had been wrong to place no reliance on "publicly available Shell corporate documentation which had been produced in the context of fulfilment of listing obligations."[37]

When the strategic report was proposed by the Company Law Review (under the title of an "Operating and Financial Review"), the Steering Committee for the Review attached importance to putting "the onus on the directors to give their own account, based on their own

[33] In the case of climate change disclosures the CA's requirements are enhanced by the Listing Rules (LR 9.8.6(8)).
[34] CA 2006, s 414CB (operative from December 2016).
[35] See further below §4.
[36] At [61].
[37] At [111].

judgement, of the matters which are important in assessing the performance and prospects of the business. This is calculated to ensure that boilerplate formulae will be treated by the market with the distrust they deserve."[38] To this end, two amendments were made to the standard regime applying to the annual accounts. First, the strategic review is not subject to a full audit (which might make the review the auditors' review rather than the directors') but is checked by auditors only for consistency with the corporate documents which are subject to full audit.[39] Second, to encourage directors to be forthcoming in the strategic review, statements it contains will trigger director liability to the company only if they are at least recklessly made (and so not on the otherwise applicable negligence standard).[40]

There is a risk that the developments in tort liability for parent companies has undermined this policy. Directors now have an incentive to reveal the minimum necessary to comply with the statutory and regulatory requirements. If they do more, they may be increasing the liability risk of the company. One can imagine that, after these Supreme Court decisions, the parent company's lawyers will have a greater input into the documents posted on the company's web-site, and the company's communications departments a lesser one. It will be interesting to see how this tension is resolved. On the one hand, there is growing regulatory and investor pressure on companies to reveal increasing amounts of and increasingly detailed non-financial information; on the other hand, the company's lawyers will be well aware of the litigation risks. My guess is that the former will win out.[41]

It is inherent in the courts' approach to the direct duty of care that the control tests developed above will not necessarily lead to the conclusion that a duty of care on the part of the parent has been triggered in relation to the activities of the subsidiary. In *AAA v Unilever plc*,[42] where Sales LJ articulated the "ordinary tort" approach which was subsequently endorsed by the Supreme Court, the court refused to categorise the parent as an anchor defendant, because the evidence did not disclose an arguable case that the parent owed a duty of care to the claimant employees of the subsidiary. Those employees had been victims of inter-tribal violence following presidential elections in Kenya, when the tea plantation in which they worked and the associated housing in which they lived had been attacked by "marauding mobs" as part of

[38] Company Law Steering Group, *Final Report*, 2001, Vol. 1, 3.40.
[39] CA 2006, s 496.
[40] CA 2006, s 463. Directors' liability to persons other than the company is excluded entirely.
[41] See further the discussion below at §4.
[42] [2018] EWCA Civ 1532.

a national breakdown in law and order. The Court of Appeal upheld the first instance judge's conclusion (Elisabeth Laing J, as she then was) that the parent owed the employees of the subsidiary no duty to protect them from such an event. The evidence showed that the subsidiary carried out its own crisis management training, drafted its own policies and received no specific advice from the parent. Although the parent was seeking to run the Unilever group as a single operating unit and had developed group-wide policies, in particular, a crisis management policy, that policy made it clear that responsibility for producing crisis management procedures lay below the parent company level.[43]

B. The Dangerous Situation Theory

In *Begum v Maran (UK) Ltd*[44] the Court of Appeal refused to strike out a claim that A is liable to C where A is responsible for or has created a danger which B has then exploited and, in so doing, has caused harm to C. The defendant was a ship-broker which had undertaken to dispose of ships owned by other group companies when they reached the end of their useful lives. The defendant disposed of the tanker in question for cash to Hsejar Maritime Inc, a company incorporated in Nevis, on the basis that Hsejar would arrange for the ship to be broken up. Hsejar arranged this with the Zumar Enterprise Yard in Bangladesh. The "yard" consisted essentially of tidal mud flats on which the tanker was beached and was then broken up without significant dockside support structure and in extremely unsafe working conditions. The claimant's husband fell and died in the breaking up process.

The Court held that, on the assumed facts, it could not be said that there was no reasonable prospect of success for the argument that the claim fell within an exception to the *novus actus interveniens* doctrine. Although most of the previous cases dealing with this exception had arisen in the public sector, it was arguable that the defendant played an active role by sending the vessel to Bangladesh, knowingly exposing workers to the significant dangers which working on this large vessel in Bangladesh entailed.[45] The knowledge arose from two main facts of which the defendant was aware. First, the structure of the industry was that, for ships of this size, the only safe break-up yards were in China, while it was known that Bangladesh

[43] See also *Thompson v The Renwick Group plc* [2014] EWCA Civ 635 – holding company with purely coordinating functions owed no duty of care to an employee of a subsidiary. This was so even though the parent had appointed a director to the subsidiary to be responsible for health and safety at the subsidiary (asbestos risk again).
[44] [2021] EWCA Civ 326.
[45] At [64].

(and some other countries) operated extremely unsafe "beaching" operations. Second, the price paid to the defendant by Hsejar was one which was appropriate only on the basis that the ship was not to be broken up in China, where costs were higher, but in Bangladesh. Finally, the defendant could have protected itself by including and enforcing a safe break-up clause in the contract with Hsejar.[46]

What are the implications of this decision for the subject-matter of this paper? It is clear that the "dangerous situation" theory is narrower than the managerial control theory. Managerial control on the part of the parent over at least some elements of subsidiaries' activities is likely to arise routinely out of the centralisation of the group's businesses. Whilst groups vary in the extent to which they centralise decision-making, a completely decentralised approach, akin to a portfolio of passive investments, is a rarity. A dangerous situation, by contrast, is not likely to arise routinely from group centralisation but only episodically in the context of particular business activities. Even then, "it will only be in a relatively extreme case that the 'creation of danger' exception will operate."[47]

On the other hand, the dangerous situation theory is not linked necessarily to the activities of parent companies and their capacity to exert managerial control over subsidiaries. The defendant in the case was not the group parent but rather a subsidiary providing ship-broking services to the group as a whole. More important, the implication of the case for companies is that they need to supervise the activities, not only of subsidiaries, but also of contractors (Hsejar) and sub-contractors (Zumar). That supervision need not involve day-to-day monitoring of contractors and might not need to go beyond the inclusion and supervision of appropriate contractual provisions. But complete inattention once a dangerous situation has been created clearly will generate a liability risk. In the light of the extension of due diligence requirements under the regulatory law discussed below to the whole of the company's "value chain", *Marin* is a potentially important development in tort liability.

III. The Issue in Regulatory Law

Courts using duty of care concepts to fashion direct parent company liability for wrongs committed within subsidiaries need to take as given the managerial arrangements between the

[46] In fact, the contract contained such a clause but the court concluded that neither the defendant nor Hsejar expected it to be enforced (at [69]).
[47] At [63].

parent and the subsidiary which the parent has chosen to put in place or has purported to do so. Most human rights and environmental lawyers will have none of this. For them, the *capacity* of the parent to exercise control over the subsidiaries should be the basis for imposing on the parent a duty to prevent or minimise wrongdoing occurring in subsidiaries and for imposing liability on them if they do not. Indeed, the capacity argument is extended so as to include wrongdoing by contractors, both direct and indirect, to the company and its subsidiaries. In the jargon, the company should be required to exercise control over its entire value chain, ie all the established business relationships which exist between it and its suppliers and customers.

Traditionally, those taking this view have been in favour of the "single economic entity" theory of parental liability which was rejected in *Adams*. Today, however, they tend to support a turbo-charged version of the tort theory as the best way forward. Under this theory a parent should be subject to legal incentives to exercise a proactive control over subsidiaries and contractors so as to reduce the risk that human rights (and other) violations will be committed within these other entities. While it is true that the risk of direct tort liability may induce parent companies ex ante to exercise control over the subsidiary's activities, the regular tort theory leaves the parent with more freedom than the turbo-charged version to craft intra-group functions as it wishes. First, under the ordinary tort theory the company is free to decide to what extent it will run the risk of tort liability ex post even if it does involve itself in the subsidiary's decisions ex ante. In other words, there is no scrutiny ex ante of how good a job the parent does in reducing risks within the subsidiary and, if no harm in fact occurs, it will be subject to no liability ex post. Second, and more important, the parent is free to steer clear of involvement in the subsidiary's decision-making in the areas most likely to generate tort litigation (subject to the reputational factors discussed below).

So the more demanding duty imposed on the company involves a shift from standards developed by courts using private law to regulation crafted by the legislature. Nevertheless, the regulation is still reliant on the corporate structure: essentially it co-opts the board and senior management of the company to implement an enhanced oversight and monitoring duty in relation to the company's observance of human rights standards. A "due diligence" obligation is imposed which requires parent company involvement in reviewing and controlling the risks arising in subsidiaries (and contractors), at least in the areas of human rights infringements and environmental damage. The company no longer has the freedom to leave to individual subsidiaries the task of developing and implementing policies in relation to these risks. Failure

to discharge this duty may lead significant administrative penalties for the company, even if no harm to third parties occurs, as well as to civil liability if it does. Thus, while at one time the decision in *Chandler v Cape* was seen revealing domestic tort law as a promising way to bring human rights abuses before the courts,[48] the majority view today among human rights lawyers is probably that *Chandler* represented only an interim step in the necessary legal development towards a more intrusive legal structure.

It is true that the regulatory strategy has been advanced to date only in relation to breaches of core human rights and environmental protections located in international treaties and conventions. This is in contrast to the tort theory which in principle applies to all interests protected by the law of tort. However, the situations where the parent company is most likely to be found to owe a direct legal duty to third parties under the tort theory are precisely those where significant numbers of third parties are at risk of harms inflicted in breach of the international standards, because it is precisely in such cases that the company has the strongest incentives to involve itself in the controlling the subsidiaries' activities. Thus, in all the post-*Chandler* cases discussed above, the argument was that the company owed a duty of care to prevent the occurrence of events which were both tortious and in breach of international human rights or environmental standards.

A. The Role of the United Nations

This regulatory approach to parent company liability can be traced back to a 2008 report by Professor John Ruggie (Kennedy School of Government, Harvard), acting as the Special Representative of the Secretary General of the United Nations on the issue of human rights and transnational corporations. His report to the General Assembly's Human Rights Council advanced the propositions that transnational companies should "respect" human rights and that effective remedies for breaches should be provided in the case of non-respect.[49] The report led initially to the UN's *Guiding Principles on Business and Human Rights*, 2011,[50] to which multinational companies were invited to subscribe on a voluntary basis, as many did. However, in 2014 the Human Rights Council established an "open-ended intergovernmental working group" on transnational businesses and human rights. Its brief was to develop an instrument

[48] Palombo, 'Chandler v. Cape: An Alternative to Piercing the Corporate Veil beyond Kiobel v. Royal Dutch Shell' (2015) 4 *British Journal of American Legal Studies* 453.
[49] Available at media.business-humanrights.org/media/documents/files/reports-and-materials/Ruggie-report-7-Apr-2008.pdf.
[50] United Nations, Office of the High Commissioner on Human Rights, 2011 (HR/PUB/11/04).

which would make human rights standards embodied in international treaties and conventions directly and legally binding on companies. These international instruments had previously operated, by and large, only between and among states. The establishment of the working group was thus an acknowledgement that the traditional system of inter-state international law had operated with only partial success in the human rights field. The aim now was to develop an instrument which would be binding on companies irrespective of whether their state of incorporation or the state of operation had ratified and implemented effectively the international agreements.[51]

B. The Proposed EU Directive on Corporate Sustainability Due Diligence

Of course, the proposed treaty, making human rights standards binding on companies, suffers from the same core defect as the treaties containing the substantive human rights standards, ie that it will be binding only on companies operating in states which have ratified and implemented the proposed treaty. It is in this context that a proposal from the European Commission for Directive on Corporate Sustainability Due Diligence[52] is important. The Commission's draft was heavily influenced by that of the working group, perhaps not surprisingly in view of the Commission's membership of the group.[53] At the time of writing, the proposal has achieved a common position in the Council, which took a somewhat more cautious approach than the Commission but left the basic structure of the proposal intact.[54] Some of the more significant differences between the Commission and the Council are noted below but it is impossible to predict which version will eventually predominate.[55] What can be said is that the proposal, when adopted, will pre-empt the decisions of the Member States whether to sign any document which may emerge from the UN working group, by making its

[51] For the working group's latest draft of 2021, see www.ohchr.org/sites/default/files/Documents/HRBodies/HRCouncil/WGTransCorp/Session6/LBI3rdDRAFT.pdf

[52] COM(2022) 71 final, 23.2.2022 (available at eur-lex.europa.eu/resource.html?uri=cellar:bc4dcea4-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC_1&format=PDF). The Commission's draft applies to all companies which meet the relevant size standards, based on the number of employees and turnover (Art 2), but it seems clear that its main impact in practice will be on parent companies.

[53] Also influential were the French reforms of 2017 (law No. 2017-399 of 27 March 2017), which also reflected the UN initiatives. See A Pietrancosta, *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives* (ECGI Law Working Paper 639/2022 – available at ssrn.com/abstract=4083398).

[54] Available at data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf. There will now be tripartite negotiations among the Commission, the Council and the Parliament before a final version emerges.

[55] Unless otherwise indicated, the references are to the common position of the Council.

underlying ideas mandatory on EU Member States and, thus, the international standards binding on covered companies via the "due diligence" obligation.

The Commission's proposal sought to make those standards binding throughout the "value chain" of the companies it applies to, even, in fact especially, those parts of the value chain which are located outside Europe. In short, the back-sliding of non-European states in relation to human rights and environmental standards is to be made good, at least in part, by establishing in the laws of EU member states a requirement that companies incorporated (or in some cases, simply operating) in the EU abide by those standards when operating outside the EU. This point is recognised, albeit in more diplomatic language, in the *travaux préparatoires* of the Directive:

> "By including European companies' global supply chains into their scope, and by recognising that the most salient adverse impacts on human rights and on the environment occur mainly outside the EU, the policy options have a strong external dimension through their impacts on supply chain actors and stakeholders in third and developing countries."[56]

The definition of the value chain, as adopted in the Commission's proposal, has turned out to be a hotly debated issue. As proposed, the term covered not just subsidiaries and affiliates of the company but also their contractors and sub-contractors, across the whole of the company's "value chain". However, the Council's common position is more cautious about going beyond the company's supply chain and including the "downstream" activities of customers. In fact, it eschews the term "value chain" and prefers the more open term "chain of activities". How this question will be resolved is unclear at the time of writing.

i. A Little Detail on the Proposed Directive

It is probably very difficult for governments these days to put forward corporate proposals which do not contain the word "sustainability" in the title or the rationale. Sustainability is, of course, a word of many possible meanings, but in the context of the Commission's proposal it

[56] Commission Staff Working Document, *Impact Assessment Report*, 23.2.2011 (SWD(2022) 42 final) para 6.1.5. The authors did not investigate the further question whether host countries will always welcome the corporate intervention. See, for example, the reaction in China to H&M, the Swedish retailer, when it announced it did not use products from a Chinese province where slave labour was said to be deployed. The retailer was excluded from online sales engines for a while and Chinese consumers switched away from its products. ('H&M and Nike face China backlash over Xinjiang stance' *Financial Times*, March 31, 2021.

has a rather limited meaning, which reveals its links with the work of the UN. It creates "obligations for companies regarding actual and potential human rights adverse impacts and environmental adverse impacts" (Art 1) and those adverse impacts are defined as those resulting from breaches of a list of international conventions laid down in an Annex to the proposed Directive (Art 3(b) and (c)). Although the source of human rights and environmental obligations to be made binding on companies is confined to the international sphere, the Commission has drunk heavily from it. The Annex in the Commission's proposal identified 2O human rights provisions (reduced to 14 in the Council's version) and 12 environment ones in relation to which the company must perform due diligence. It should be noted that the obligation to carry out due diligence is not dependent upon these international standards being binding (apart from the proposed Directive) on the company or any of its business partners, whether in their country of incorporation or the country of operation.

a. Due Diligence

The central element in the proposal is the duty on the companies falling within its scope to carry out an assessment of the human rights and environmental risks contained in its business relationships and to take steps to prevent those risks eventuating or to minimise their likely impact. The duty thus goes beyond the idea that you should identify risks before you decide whether to enter into a transaction or a new line of business. Having identified those risks (as required by Art 6), the company must take steps to prevent the occurrence of potential adverse impacts or to reduce the probability of their happening (Art 7, including risks that should have been identified under Art 6 but were not). The company must also take steps to bring actual occurrences to an end or to minimise their impact, including the payment of financial compensation (Art 8). Under both Arts 7 and 8 companies may be required as a final step to end the business relationship in which the breaches are occurring, either temporarily or permanently. How to deal with the risk of human rights abuses in subsidiaries' operations is, thus, no longer to be a matter for the parent company – subject to the risk of tort liability ex post – but is specified in a regulatory instrument.

b. Monitoring and Enforcement

The regulatory credentials of the proposal are demonstrated very clearly in its provisions on enforcement and monitoring. As to monitoring, the company itself must review at least every two years its implementation of its due diligence obligations (Art 10). Those likely to be

harmed by the adverse impacts, employee representatives and non-governmental organisations (NGOs) active in the human rights field may monitor the company through a "complaints procedure" which the company must establish where they have "legitimate concerns regarding actual or potential adverse impacts" (Art 9). Governments and the wider society may monitor the company by reacting to the annual report on the discharge of its due diligence obligations which the company is required to make (Art 11). Finally, governmental supervisors (to be established in each Member State, not at Union level) may demand information from the company and initiate investigations into the company's discharge of its obligation, either on their own motion or on a complaint from a third party (Art 18).

As to enforcement, the supervisors are to have the usual wide range of administrative sanctions, including the imposition of financial penalties related to the size of the company's turnover. But private enforcement is provided for as well. Those actually harmed through the failure of the company to discharge its due diligence responsibilities under Arts 7 and 8 are to have a right of action against the company in the courts of the Member State in which the company is incorporated, provided the company's breach was intentional or negligent (Art 22).[57] This provision does not extend to making the company liable for the harm caused by its business partners alone, even if, apparently, the company was in breach of its obligations under those articles. Since the Directive imposes due diligence obligations only on the "top" company, Art 22 presumably does not operate so as to make entities lower down the chain liable for the harm cause by breaches of Arts 7 and 8 at the top of the chain. However, national law, if any, which makes subsidiaries and business partners liable for the harm caused by them is preserved.

c. Non EU-incorporated Companies

The proposal applies only to large companies defined by reference to turnover and number of employees, with a lower threshold for companies operating in businesses where there is thought to be a high risk of human rights and environmental abuses. The criteria will trigger the application of the Directive only if they are met over two consecutive years. (Art 2).

Figure 1

	Incorporated in EU	**Incorporated in Third Country**

[57] This liability will be shaped by national law (for example, on causation and remoteness).

General Rule	500 ees + €150m turnover world-wide	€150m EU
“High Risk Sectors”	250 ees + €40m ww (€20m high risk)	€40m EU (€20m high risk)
Estimated Coverage	13k companies	4k companies

As Figure 1 makes clear, the proposal applies, not only to companies incorporated in an EU Member State, but also to companies incorporated in third countries which do substantial amounts of business in the EU. (The specification of the appropriate regulator for third-country companies is to be found in Art 17.3.) The extension may raise hackles in some quarters, but it is not a new approach. Thus, the Modern Slavery Act 2015 (UK), Part 6 (Transparency in Supply Chains etc) requires an annual statement of the steps the company has taken, if any, to eliminate slavery and human trafficking in its supply chain. This obligation applies, subject to thresholds, to “a body corporate (wherever incorporated) which carries on a business, or part of a business, in any part of the United Kingdom.”[58]

While the principle of applying human rights law to companies incorporated outside the jurisdiction but carrying on business has become uncontroversial, there is likely to be some debate about whether the criteria for the inclusion of outside companies are equivalent to those for inside companies. However, one may wonder how important the issue is in fact. It seems likely that most companies, incorporated in third countries but carrying on significant business within the EU, do so via EU-incorporated subsidiaries, which will be subject to the same rules as any other EU-incorporated company. If this is so, the third-country provisions can be seen mainly as a prophylactic against decisions by companies incorporated in third countries to move their EU business from a subsidiary to a branch.

IV. Two Fundamental Questions about Tort Liability and Due Diligence Obligations

A. Why Do Companies Breach Human Rights and Environmental Standards?

We noted above the economists’ take on externalities. In the economists’ model, the company shifts costs onto third parties without compensation or, if they naturally fall on third parties, the company leaves them there, because this reduces the company’s costs of production and

[58] S 54(12).

thus increases its profits. In a competitive market, companies are no doubt incentivised to reduce their costs of production, and so to take advantage of externalities, in order to maintain or strengthen their competitive position. Incentive payment structures for managers may operate in the same direction. However, the outcome is not socially efficient because the company's costs of production are artificially lowered. It follows from this analysis that efficiency from a societal point of view requires some mechanism whereby externalised costs are required to be taken into account by the company when calculating its costs of production.[59] However, the economists' discussion does not investigate the existence of any counter-incentives to managers' robotically taking advantage of any externalisation opportunities which arise. In this they are followed by many human rights and environmental activists. In the area under discussion, there may indeed be constraints on the willingness of senior management of large companies simply to trample on the human rights of others or to degrade the environment in the name of operational efficiency. The weight of these countervailing incentives needs to be assessed if the optimal legal rules in this area are to be designed.

Recent research from the United States shows that large US companies have introduced policies and procedures designed to secure the company's compliance with international conventions the US has never signed or, during Mr Trump's presidency, was in the business of resiling from.[60] While this research does not establish the effectiveness of the policies introduced, the research suggests that large companies are not indifferent to their impact on human rights and the environment. The research suggests that the two main explanations for the adoption by large US companies of non-binding international standards lie in the areas of reputation and risk management. As to risk management, as indicated above, breaches of the international standards are likely to count as independent torts in the jurisdictions where the company operates, so that compliance with the standards reduces the risks of such litigation. Second, and more interesting, are the reputational reasons for the steps taken. Directors and senior managers of large public companies are not likely to want to view themselves or to be viewed by others as trampling on human rights or degrading the environment; talented employees may be less willing to work for companies with a bad reputation in these areas;

[59] As Coase famously pointed out, in a world of zero transaction costs that mechanism could simply be the law of contract: those harmed and those inflicting the harm would simply bargain about how the costs of the harm should be allocated amongst them (R H Coase, 'The Problem of Social Cost' (1960) III *Journal of Law and Economics* 1).

[60] Hathaway, Ewell and Nohle, 'Has the Alien Tort Statute Made a Difference?' (2022) 107 *Cornell Law Review* (forthcoming); Parella, 'International Law in the Boardroom' (available at ssrn.com/abstract=4045579).

increasingly investors are interested in the performance of their company along non-financial dimensions as well as along financial ones, as witness the rise in "ESG" funds;[61] and customer-facing companies may suffer a backlash from consumers if their record in these areas is poor. Moreover, provided competing companies comply with the international standards, the market position of any one company is not necessarily undermined by adherence to them.

The EU's Regulatory Scrutiny Board, when delivering a (second) negative opinion on the Commission's proposal, criticised the Commission for not exploring this line of argument. The Board stated that "The problem description remains vague . . . It does not provide convincing evidence that EU businesses . . . do not already reflect sustainability aspects or do not have sufficient incentives to do so."[62] If supported, this argument does not remove the case for the use of law to promote compliance with international standards in these areas, but it does point in the direction of providing incentives for companies to comply voluntarily with the international standards ("nudging"), perhaps via mandatory disclosure of corporate policies, whilst reserving liability for cases where the company has not in fact implemented adequately its adopted policies. Authoritative guidance on what compliance entails in the human rights area already exists in the shape of the UN's *Guiding Principles on Business and Human Rights*, 2011,[63] and the OECD's *Due Diligence Guidance for Responsible Business Conduct* (2018),[64] which are linked to the OECD's *Guidelines for Responsible Business Conduct* (2011),[65] while liability for non-compliance with adopted policies is a task which, as we have seen in Section 2, national tort law is already undertaking. Nevertheless, civil society groups generally regard this approach as too lax and they succeeded in persuading both the Human Rights Council of the UN and the EU Commission not to adopt it.[66]

[61] See W-G Ringe, *Investor Led Sustainability in Corporate Governance*, ECGI Law Working Paper 615/2021 for a review of the data on ESG investing and the argument that bottom-up investor pressure is a better mechanism for fostering corporate sustainability than top-down legislation.

[62] *Regulatory Scrutiny Board Opinion, Proposal for a Directive . . . on Sustainable Corporate Due Diligence*, SEC(2022) 95, 26.11.221, p 1.

[63] United Nations, Office of the High Commissioner on Human Rights, 2011 (HR/PUB/11/04). This was the UN's first formal response to the Ruggie Report (above n 49) and is not to be confused with the binding Treaty which the Working Group of the Human Rights Council has been developing (above n 51).

[64] mneguidelines.oecd.org/mneguidelines/

[65] doi.org/10.1787/9789264115415-en

[66] Given the origin of the proposed Directive in the UN Human Rights Committee's working group, this is perhaps not a surprising stance. The non-state members of that working group, of which there are many, are overwhelmingly human rights NGOs, with whom the reputational and risk avoidance arguments mentioned above probably carry little weight. For the list of members see the Annex to the minutes of the 49th Session of the Human Rights Council, 2022 (A/HRC/49/65).

B. How To Cope with State Complicity in Human Rights Abuses?

In the previous section it has not been argued that there have never occurred significant breaches of human rights and environmental standards in which companies are involved nor that such breaches will never occur in the future. However, it is not often noticed or remarked upon that many of the most highly distressing, widespread and difficult-to-fix human rights cases have a common feature. This common feature is that the host state where the wrongdoing has occurred is complicit in the abuses and perhaps even initiated them. Although putting the emphasis the other way around, the Ruggie Report for the UN Human Rights Council made this same factual point. Having surveyed the worst allegations of corporate-related human rights harm, it reported that "a significant fraction of the allegations involved companies being complicit in the acts of government or armed factions."[67]

The reported cases from around the world give support to this statement. In *Kiobel v Royal Dutch Petroleum Co*[68] the allegation was that the Nigerian government engaged in violent suppression of Nigerian communities protesting against pollution resulting from a pipeline operated by Shell. (The US Supreme Court held the claim did not fall within the Alien Torts Statute.) In *Nevsun Resources Ltd v Araya*[69] the Supreme Court of Canada refused to strike out (but did not substantively decide) a claim that Nevsun had breached the human rights of Eritrean citizens who had been subject to a system of forced labour in the construction and operation of a mine which was operated by the defendant, and that this breach of customary international law was justiciable in the Canadian courts. The forced labour system took the form of a mandatory national service programme operated by the government, under which workers were supplied to those constructing and operating the mine. The construction companies were owned and operated by persons who were part of the political and social elites of Eritrea. It seems likely that the governments in both these cases were prepared to commit these abuses against their own citizens because they regarded the multinational investment as essential to the development of their economy and to the government's revenues. In addition, the government and individuals closely associated with it had a significant economic interest in the business, through an equity stake in the group's local operations held by a host state-owned company (which is common) or through lucrative contracts linked to the multinational's business.

[67] Above n 49, para 16.
[68] 569 US 108 (2013), US Supreme Court.
[69] 2020 SCC 5.

In other cases the harm was not initiated by the host state but that state failed in its duty to maintain law and order. In *Okpabi v Royal Dutch Shell*[70] (UK Supreme Court) the claim by the local communities was that their drinking water had been contaminated by spills from a pipeline operated by a Nigerian subsidiary. The spills were apparently the result of sabotage and other criminal acts by third parties, which the state had not prevented and perhaps an even in some part condoned. In *AAA v Unilever*[71] (English Court of Appeal), as we have noted, the claim arose out of a national breakdown of law and order and widespread inter-tribal violence, during which employees of the defendant, living and working on tea plantations, suffered violent personal attacks.

The difficult question these stark cases raise is, what is it appropriate to require the company to do in response? On the one hand, it is not appropriate to permit the company to turn a blind eye to the abuses simply because they result from the action or inaction of the host state. On the other hand, bringing them to an end on a permanent basis or even significantly moderating them is likely to require the re-setting of embedded political and social structures in the host state, something which it is unlikely that the company has either capacity or the legitimacy to bring about by itself. In a few rare cases, the company's threat of exit will give it the necessary leverage to bring about a change in the host state's behaviour. Generally, however, there will be a competitor, either local or based in a home state with a different view of human rights, which is willing, indeed anxious, to replace the incumbent, acquiring its assets at a discounted price.

In the absence of such leverage, the incumbent will be faced with the choice between actual exit and remaining and exercising voice, which, given the limitations on the company's leverage, will probably produce a less than complete remediation of the abuses. If one runs the facts of the above cases through Art. 8 of the proposed Directive, it is far from clear what analysis the supervisory bodies or courts of the Member States would apply. There is some general language in Art 8 upon which the company could seek to rely to justify the (limited) extent of its reaction, such that the company is required to take only "appropriate measures" to bring actual adverse impacts to an end or to minimise them; or to take mitigating measures only to the extent that they are "proportionate" to the "contribution of the company's conduct to the adverse impact." However, it will be very difficult for the company to judge ex ante how

[70] Above n 16.
[71] Above n 14.

supervisors or courts will make the judgements inherent in these tests, whilst the mere fact of litigation, even if the company is successful, may entail a reputational harm which the board assesses as too severe for the company.

Thus, companies are likely to favour exit in this class of case. It is true that Articles 7 and 8 require exit only as a "last resort" and do not require it at all when "there is a reasonable expectation that the termination would result in an adverse impact that is more severe than" the actual or potential adverse impact that would exist if the company remained. (Arts 7.7 and 8.8). But, as a commercial matter, exit is always available to companies, even when not required by the proposed Directive. The reactions of some of the companies involved in the above litigation suggests that exit will often be the most attractive of the available options. Thus, Unilever, although winning its case against it in the English Court of Appeal, shortly afterwards decided to dispose of its tea plantations and associated brands to a private equity company. According to an analysis in the *Financial Times*[72] this was because Unilever feared the reputational harm it would suffer if it held onto them and, in particular, a downgrading of its ESG ratings, risks to which the private equity purchaser was thought to be less exposed. Equally, the decision by Shell, which has faced litigation in both the UK and the Netherlands, to exit its on-shore oil production activities in Nigeria (but to retain the off-shore ones) was apparently driven in part by a desire to reduce the reputational harm it was suffering from repeated litigation.[73] There is nothing in either company's actions which suggests that, in the first case, the risk of harm to the employees from inter-communal conflict or, in the second, of environmental degradation from the pipe-line will be reduced by the exit.

An alternative, though probably less likely, form of exit, would be for the (parent) company to exit from the state in which it faces liability. In the wake of the judgment on jurisdiction, Vedanta Resources plc de-listed from the London Stock Exchange in October 2018 when its Indian controlling shareholder and founder bought out the minority shareholders.[74] The company remains incorporated and so domiciled in England (though now as a private company) and so is still open to tort suits brought against it by foreign claimants. However, it is no longer subject to the disclosure requirements of the Companies Act, because it is no longer

[72] 16 February 2022, 'How Unilever's tea business became a test of private equity's conscience'.

[73] The CEO of Shell is reported to have said: '"We cannot solve community problems in the Niger Delta — that's for the Nigerian government perhaps to solve . . .We can do our best, but at some point in time, we also have to conclude that this is an exposure that doesn't fit with our risk appetite any more.' (*Financial Times*, 'Nigerians blame Shell for 'community problems' in Niger Delta', 1 April 2022.

[74] 'Vedanta's London exit fails to stem scrutiny of Indian miner', *Financial Times*, October 17, 2018.

“quoted”, or of the Listing Rules, so that such litigation will be more difficult to mount. (The company itself explained the decisions as part of a plan to simplify the group structure.) This was a relatively low-cost step for the company to take. The overwhelming bulk of its operations are located outside the UK and so its presence in London was mainly for financing purposes. However, the parent holds a majority stake in a Mumbai-listed company which, with the development of Indian capital markets, can be used as a possibly better-informed conduit for the company’s financing needs.[75]

In my view, litigation and straight-down-the-line supervisory action are unlikely to bring about a satisfactory forward-looking resolution to these deep-seated problems. Indeed, in some cases litigation may impede more promising efforts aimed at addressing the underlying problems. In *Nestlé USA Inc v Doe*[76] the US Supreme Court was presented with an Alien Tort Statute claim against the US subsidiary of Nestlé, arising out of the use of child labour on cacao farms in the Ivory Coast. Nestlé neither owned nor operated the farms but had an exclusive supply contract with the farm operators. It was accused of aiding and abetting the use of child labour. The US Supreme Court turned down the claim on the grounds that the harm had occurred outside the US and the supply contract was not enough to implicate the US company in the wrongdoing. Assume, however, the same facts but involving an EU subsidiary of Nestlé after the enactment of the proposal. The EU subsidiary would fall within the Directive and so be required to discharge its obligations under Arts 6 – 8 of the Directive. It would be at significant risk of administrative fines and civil damages because of its involvement with the produce of the cacao farms. Yet, this would be a counter-productive outcome. A significant background fact in this case – which was legally irrelevant to the litigation, except that it caused the US government to support Nestlé – is that there was in place a partnership agreement between the US Department of Labor, the government of the Ivory Coast and the company, aimed at resetting the economics of cacao production in the country. As part of its partnership, Nestlé supplied various resources and training to the farmers. As some of the Justices commented, these were “the same kinds of activity that respondents contend make petitioners liable for violations of international law. Companies or individuals may be less likely to engage in intergovernmental efforts if they fear those activities will subject them to private suits.”

[75] The Zambian mine at the heart of the litigation was later expropriated by the Zambian government, which proposes to sell it to a new operator, most likely a Chinese company (*Financial Times*, ‘Investors rattled by takeover of Zambian mining operation’, February 18, 2022).
[76] 141 S Ct 1931 (2021).

If exit is to be a true last resort for companies covered by the proposal, what is needed is an inducement for companies to exercise voice rather than exit, when voice is likely to be more effective than exit in addressing human rights violations. Look as hard as one likes, however, no such safe harbour provisions are to be found in the Commission's proposal. In fact, Art 18(4) specifically rules out protection against supervisory sanctions and private litigation when the company engages in remedial action after being found in breach. It is not as if the Commission's attention was not drawn to the point by the Regulatory Scrutiny Board (again). As the Board put it, the Commission "should better assess the risk of 'sustainability leakage'. If EU companies will ultimately have to withdraw from certain suppliers due to sustainability issues, third-country companies (if out of the personal scope) could take over these suppliers and thereby gain a competitive advantage and supply chain control, while leaving no improvement in overall human rights and environmental performance."[77]

There is thus scope for a Morton's fork argument here. In the standard case, the reputational pressures on management and companies make the adoption of rules on due diligence as strong as those contained in the proposed Directive a form of over-kill, whereas, when the host state lies at the origin of the abuses, corporate liability rules generate exit by the company without improving the lot of those suffering from them.

V. Conclusion

This paper has argued that UK law has moved away from the position where the parent was not liable for the subsidiary's torts because the tort victims of the subsidiary could not pierce the corporate veil of the subsidiary so as to make the shareholder (the parent company) liable. Now, under domestic tort law, depending on the degree of control exercised by the parent over the risky activities of the subsidiary, the parent may owe a direct duty of care to those harmed by the subsidiary's activities. The EU proposal would make the parent liable to those harmed if the parent has not exercised the level of control over risky activities the court or a regulator thinks it should have exercised, so that the parent's freedom of action in this regard is narrowed.

Consequently, in this area, through both tort and regulatory developments, the rule against veil piercing and, pro tanto, asset partitioning between the parent and the subsidiary has been side-stepped. Arden LJ (as she then was), as a leading judicial voice in the company law area, was

[77] Above n 62, p 4.

alive to the company law implications of the Court of Appeal's decision in *Chandler*, which set the UK courts off on this new tack . She said: "I would emphatically reject any suggestion that this court is in any way concerned with what is usually referred to as piercing the corporate veil. A subsidiary and its company [sic] are separate entities." Although this statement is doctrinally clearly correct, it does not meet the functional point. The decision did restrict the scope of the limited liability of the parent for the subsidiary's wrongdoing, and thus the partitioning of the assets as between parent and subsidiary. In the specified circumstances, the company is now directly liable for the harm caused by the wrongdoing of the subsidiary by virtue of a control failure on the part of the parent. The separate legal personalities of the parent and subsidiary are maintained, but the victims of the subsidiary's wrongdoing now have access to the assets of the parent to satisfy their claims. In other words, asset partitioning requires more than the maintenance of the separate legal personalities of the parent and the subsidiary. After all, if the subsidiary were routinely treated as an agent of the parent – this was one of the arguments unsuccessfully advanced in *Adams v Cape* – the separate legal personalities of the parent and subsidiary would be maintained – indeed, agency doctrine demands this - but functionally the parent would routinely be liable for the obligations of its subsidiary.

Does the above mean that, under either the domestic developments or the EU proposals, we have moved, almost without realising it, to accepting the qualifications to asset partitioning which law and economic scholars have advocated for some time? The answer is clearly in the negative. Hansmann and Kraakman's argument[78] for unlimited, pro rata shareholder liability for corporate torts was advanced mainly on the basis of an analysis of free-standing companies, whereas the domestic and EU developments have their core application in relation to groups of companies, though both to a limited extent have an application outside groups. Despite these extensions, the crucial point from the perspective of unlimited liability for corporate torts is that, if a parent company falls foul of either the domestic rules or the EU proposals, there is nothing in them which removes the limited liability protection of the shareholders of *that* company.[79] The rules are about expanding corporate liability for torts and breaches of international standards committed by other entities over which the company has exercised, or could have exercised, some relevant level of control, not about the implementation of a general policy of shareholder liability for corporate torts.

---

[78] Above n 3.

[79] Unless tort liability is developed in the way envisaged by Lim, above, n 15.

This might suggest that the rules considered in this paper score more highly as an implementation of the Hansmann and Squires' proposal[80] for qualifying limited liability, ie a more open approach on the part of the courts to piercing the corporate veil within groups. Quite apart from the fact that the rules considered in this paper do not make use of the doctrine of piercing the veil, the more important point is that Hansmann and Squires were proposing a qualification in relation to all the debts of the subsidiary, not only those arise out of tortious liability. So the rules under consideration are in part only a partial implementation of the Hansmann and Squires proposal as well – though in another part the EU proposal goes beyond what these two authors envisaged because its reach extends all the way down the company's supply chain.

In short, the rules considered in this paper require, at least in the overwhelming majority of case, the presence of both the factors which, it has been suggested, should qualify limited liability ie both (serious) tort liability and a group (or a network) context. Though more limited in scope than either of the academic papers would indicate, the proposals can be argued, nevertheless, to achieve an important social function. They discourage the allocation of hazardous activities to under-capitalised or litigation-proof entities in a supply chain, and encourage the parent to reflect on what it can do to avoid or mitigate the harms resulting from the allocation.

Judged as techniques for discouraging externalities the EU proposals on their face do a better job than the domestic tort law developments, even though the EU proposals relate, formally, to a somewhat smaller set of wrongs than do the domestic rules. Two elements in the EU proposals are important here. First, the domestic tort rules leave the parent company in a position where it can avoid liability by not exercising – or purporting to exercise – control over the hazardous aspects of the subsidiary's activities. The EU proposals require top companies to exercise control over subsidiaries which are part of the top company's chain of business relations. However, in practice, this distinction may be less important than it seems at first sight, because of the reputational and regulatory pressures on top companies to exercise control over subsidiaries, or to assert that they do so, may generate tort liability, even in the absence of a formal due diligence duty.

[80] Above n 4.

Second, again on the face of it, the EU rules take a broader view of the scope of the top company's duty to exercise control because it expressly includes within the due diligence duty the hazardous activities of contractors, direct and indirect, as well as those of subsidiaries. This extension is somewhat diluted by provisions which exempt the company to from liability for damage caused by contractors.[81] Nevertheless, the principle of extension of the due diligence duty so as to embrace contractors is important because there is some evidence that, without it, companies are incentivised to engage in further level of delegation, beyond subsidiaries, to contractors.[82] Again, it is possible that this contrast with the tort rules is less important than it seems. First, the *Maran* decision explicitly embraces contractors, within its limited scope. Second, reputational and disclosure rules may put pressure on companies to control the hazardous activities of contractors and, if they do or hold themselves out as so doing, the theory underlying parental tort liability in relation to subsidiaries may apply to contractors as well. The parent would then fall, in relation to the contractor, into the same category as the consultant identified by Sales LJ.[83]

The choice between the direct tort and due diligence duties is likely to turn on two factors. The first is the strength of the incentives on group management to comply with human rights and environmental standards, even where they are not directly binding on the company. We have suggested that these incentives are stronger than is commonly acknowledged. The second is the capacity of regulators and courts to apply the due diligence obligation appropriately in the common and very distressing cases where the host state is a prime mover in the abuses which have taken place. The risk here of blunt application of the due diligence law is that it will result in exit from host states by companies whose parents are subject to the due diligence obligation rather than any significant alleviation of the position of those abused. Of course, this risk attaches, as we have seen, to tort liability as, but at least tort law develops incrementally, through a form of judicial conversation, which provides greater scope for back-tracking if a mis-step seems to have occurred. Courts are experienced at shaping the content of a reasonableness obligation so as to take account of the complexities of the situation in which the tortfeasor finds itself. Even judicially developed standards, however, do not entirely negate

[81] Text attached to fn 57 above.

[82] See Alessio Pacces, 'Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal', *Oxford Business Law Blog*, 20 April 2022 (www.law.ox.ac.uk/business-law-blog/blog/2022/04/supply-chain-liability-corporate-sustainability-due-diligence).

[83] Above, text attached to n 15.

the reputational pressures on companies to exit, rather than to remedy, difficult situations, even when the win the litigation, as the *AAA* case demonstrates. To some extent, however, those reputational pressures exist independently of the company's exposure to liability and, for better or for worse, are part of the environment for the conduct of modern business, at least in western countries.