

# ***Parent Companies' Liability: Possible Solutions to the Illegal Acts of Their Overseas Subsidiaries***

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**Abstract:** Multinational enterprises (MNEs) have a significant impact on the economy, politics and other aspects of host states. Due to the imbalanced development between countries and profit-oriented capital, the rights and interests of host states and their citizens may be infringed by the illegal acts of MNEs' subsidiaries. Although there have been some solutions which are relatively agreed among countries on such cases by now, the specific rules for recognizing liability are still contradictory and uncertain, resulting in victims not being able to receive adequate and effective remedies. Based on this, through researching judicial practices, analyzing specific cases in different countries, and investigating the issue of parent companies' liability for the wrongdoings conducted by their overseas subsidiaries, factors for the courts to consider when hearing relevant cases can be identified. Suggestions on the allocation of the burden of proof can also be put forward, aiming to provide a feasible path for host states to enhance protection of the rights and interests of their own countries.

**Keywords:** Multinational enterprises, parent company, host states, liability, duty of care

## **1. Introduction**

Although there is no single definition of MNEs, according to the Organization for Economic Co-operation and Development (OECD), they are often made up of companies or other entities set up in many countries and have so close relationships that they might coordinate their operations in multiple ways. Within one corporation, some of these entities might have a considerable impact on other bodies' activities [1]. Therefore, it is evident that the parent business, either through agreements or as a majority shareholder, has full authority over its subsidiary. According to the provisions of the Company Law, subsidiaries are legally independent entities. As shareholders, parent companies only have limited liability for the subsidiaries, which has led to the fact that the legitimate rights and interests of other countries violated by the wrongful acts of subsidiaries are often unable to obtain effective and adequate remedies. As a product of globalization, MNEs, depending on large-scale production, flexible operation, and high demand for their technology and products in global market, occupy a great advantage in enterprises competition, and therefore have strong economic strength. In developing countries of Asia and Africa, MNEs can even make an influence on their economic and political environment. It is acknowledged that the impact of MNEs on a nation should never be underestimated, what's more, they are also influential in the international community. At the same time, subject to economic and political conditions, when the rights and interests of the disadvantaged countries and their nationals are violated by MNEs, it is usually difficult for them to obtain reasonable

judicial aid. And that is related to parent businesses' responsibility for their affiliates' wrongdoing in host states. Based on that, by delving into possible illegal acts that may be carried out by the subsidiaries and discussing the causes and consequences, this paper combs several theories about how to define parent companies' liability under such circumstances. It also proposes optimal solutions to the problem in the light of judicial practice and concrete situation of the global community, which may provide useful reference for international human rights protection, economic development and the promotion of the globalization process.

## **2. Illegal Acts of MNEs' Overseas Subsidiaries**

### **2.1. Cases concerning Illegal Acts**

While most of the headquarters of MNEs are set up in developed countries, they consciously transfer highly polluting and dangerous enterprises to developing countries, especially by establishing subsidiaries in Asian and African countries. In addition, in many cases, being aware of the weaknesses of local and international labor laws, MNEs have always allowed illegal practices that violate labor laws to persist in pursuit of higher profits [2]. And this brings the issue that MNEs engage in economic activities in other countries which damage the local environment and infringe human rights.

#### **2.1.1. Environmental Pollution**

There are two typical cases of this type of wrongdoing. One is *Okpabi v. Shell*, which has two proceedings, the *Ogale* proceeding and the *Bille* proceeding. In the *Ogale* one, the plaintiff was a farming and fishing community in Nigeria which had a population of 40,000. In the *Bille* proceeding, the plaintiff was a remote riverine community of 2,335 inhabitants. The key issue in the case was whether Royal Dutch Shell (RDS), as the parent corporation, was liable for the oil spill as a result of negligence on the part of its subsidiary - Shell Petroleum Development Company of Nigeria (SPDC). The Supreme Court reversed the earlier judgement given by the Appeal Court and held that in that case, the duty of care of the parent should be assessed in accordance with general tort principles [3]. Another case involves three oil leakages in the Niger Delta. The plaintiffs were four Nigerian fishermen and the defendants were SPDC and RDS. In that case, the Court held that RDS, which was the operator, should take strict liability for the incidents [4].

#### **2.1.2. Tort - Violation of Human Rights**

Human rights violations committed by MNEs has been a hot topic of attention internationally. One notorious case is the Bhopal case, in which the United Carbide India Limited (UCIL), a subsidiary of the Union Carbide Corporation (UCC) in India, was responsible for a toxic gas leak at one of its factories in Bhopal. The accident consequently led to thousands of deaths [5]. Another case was filed by Chandler, who found that he had contracted asbestosis because of his previous work in Customs and Border Protection (CBP). Since CBP had no longer existed at that time, the defendant of the case was Cape plc, the parent company of CBP. The controversy of the case was centered on whether Cape plc was directly liable for the infected employees. The determination of the specific circumstance and link between the parent and subsidiary in this case showed that the defendant had a significant degree of control over the asbestos business. Therefore, the parent was accountable for preventing work-related risks. The court finally concluded that the defendant owed a direct duty of care for CBP's employees [6]. Apart from that, it is not uncommon for MNEs to breach the provisions of labor laws and exploit workers. For example, the supplier of the famous clothing brand Zara was revealed to hire workers illegally and force them to work in poor condition in 2011. The Brazilian court ultimately judged that Zara had a direct duty of care to its supplier's workers [2].

## **2.2. Causes of illegal acts**

### **2.2.1. Inadequacy of Legal System and Absence of Government Regulation**

With regard to environmental pollution, in order to achieve maximize profits, many MNEs have relocated their polluting industries to other countries, particularly to those with relatively low environmental standards, thereby causing destruction to the host states' environment. Nevertheless, because there hasn't been any widely recognized criterion concerning the determination of parent companies' duty of care, the jurisdiction of transnational environmental infringement lawsuits remains unclear, the application of the law is still uncertain, it is thus difficult to facilitate the transnational environmental governance [7]. Additionally, MNEs are not subjects of international law. The international community, as a result, cannot invoke the existing law to regulate the illegal acts of MNEs. Even though the international community and many countries have formed a multi-level soft law governance system to recognize the human rights responsibilities of MNEs, owing to the non-binding documents, the human rights responsibility framework of MNEs has always suffered from insufficient accountability and remedy. Meanwhile, the obligation of states to regulate MNEs has never been clarified and elaborated, which has led to home states' lack of governmental regulations to MNEs [8]. In practice, home states may also choose to liberalize the supervision for MNEs established on their own territories on the basis of national interest considerations.

### **2.2.2. Dilemma for Host State**

On the one hand, host states lack the incentive to regulate MNEs. The host countries of MNEs are usually developing countries (such as India, Nigeria). With the purpose of attracting foreign investment and developing their own economies, these countries tend to sacrifice the local environment and the interest of their nationals (especially the rights and interests of laborers) and accept some articles that are detrimental to their own interests when signing contracts with MNEs. Although they are obliged to prevent human rights infringement under treaties like the Universal Declaration of Human Rights, host states still choose to give up their rights and interests in terms of safeguard for human rights so as to satisfy the investment needs of MNEs. The Bhopal case mentioned above is a tragedy arising from this [9]. On the other hand, even if the host states intend to regulate the wrongful acts of MNEs, there exists an imbalance of power between host countries and MNEs. The home states of MNEs are often developed countries, which are economically and politically stronger than the host states and have more sophisticated legal systems. In comparison, it is not easy for the host states to hold MNEs responsible by applying legal principles or other provisions and treaties in the field of tort liability [7]. Besides, MNEs and their home states might impose intense pressure and thorny obstacles on host states, and gain control on them by influencing their social economic policies. All these factors have trapped the host states in the dilemma between MNEs' regulation and national interests' safeguard.

## **3. Judgment on Parent Companies' Liability for Their Subsidiaries**

### **3.1. Theories about Parent Companies' Liability**

When the subsidiaries of MNEs commit illegal acts incurring tort liabilities in host countries, the amount of damages is usually so large (particularly for environmental damage) that even the liquidation of the subsidiaries cannot fully cover it. There have been many cases where parent companies set up subsidiaries in foreign countries to avoid litigation resulting from their wrongful acts. A few international perspectives on the resolution of the foregoing issue are as follows.

### 3.1.1. Piercing the Corporate Veil

The principle of lifting the corporate veil is one of the first arguments for holding parent companies liable in MNEs' tort cases before the twenty-first century. The law provides corporation with a "veil", which endows it with separate legal personality and limited liability. This principle is a negation of the two qualities, and in some cases (e.g. concealment or evasion of shareholders' obligations) requires that shareholders assume unlimited liability for the company's debts. Examples include *Adams v. Cape Industries Plc* and *Prestige v. Petrodel Resources Ltd.* However, in contract dispute and tort cases, there is very limited room for the application of this principle because there has been no international consensus on the circumstances and criteria for its application. Therefore, although in some cases the plaintiff would refer to this principle as a basis of investigating the parent company's responsibility, the principle was rarely applied by the judges in practice. In the later cases of *Chandler v. Cape plc* and *Lubbe v. Cape plc*, the courts rejected similar claims of the plaintiffs and held that parents' liabilities should be recognized as negligent liabilities [10].

### 3.1.2. Direct Duty of Care - Tortious Liability

Another theory for determining parent firms' responsibilities is duty of care. Parents' duty of care towards their subsidiaries is not legally recognized as a separate type of liability, but is determined in accordance with the general principles of duty of care in tort law [11]. In *Chandler v. Cape plc*, the Court of Appeal listed four circumstances that should be considered when judging whether a parent company is responsible for the safety and health of its subsidiaries' employees, and followed the rules on determining a duty of care in general tort to judge whether the parent should be held liable for negligence [6]. In *James Hardie Industries Plc v. White*, the appellant appealed against James Hardie (JH) and its parent company - James Hardie Industries Plc (JHI), arguing that JH's products were defective. The Court of Appeal clarified the circumstances where a parent enterprise should take the liability for defective products of its subsidiaries. Based on the legally independent personalities of the parent and the subsidiary corporation, the liability arising from the illegal deeds of the subsidiary is tort liability of a legal entity, and the duty of care that an entity owes in tort is equally applicable to the parent. It means that the parent firm cannot rely on its independent legal personality to assert that it is immune from liability for negligence at any time. When judging if a parent owes a duty of care, it is not enough to only prove that the parent and subsidiary belong to the same economic entity, but it is also necessary to testify that the alleged wrongdoing in the case is, to some extent, caused by the control or dependency contact between the parent and the unit. These have to be determined specifically on a case-by-case basis. Similarly, the judge cited three situations in which the holding company could be found to have a duty of care [12].

In recent years, rules of a parent's duty of care for its units have been applied in some cases between the upstream and downstream enterprises in supply chain (buyers and suppliers), such as the Zara case mentioned above. The reason for this is that the courts have recognized that the purchasers, acting as the main customers of the suppliers in these cases, are able to exercise significant influence over the suppliers (e.g. Apple and Foxconn). As a result, purchasers may be held accountable for the wrongful actions of suppliers in certain circumstances.

## 3.2. Mainstream Views in Practice

When it comes to the question of whether a parent owes a duty of care for the illegal acts of its subsidiaries in the host countries, holding the parent company liable for negligence is currently more common practice in the international community. The United Kingdom(UK) law not only adopts this view, but also tends to extend such liability to enterprises involved in global supply chains [13]. The basis for holding a parent company liable for negligence is that the company fails to discharge its

duty of care to its subsidiary, thereby resulting in the subsidiary committing a tortious act that causes damage. This approach doesn't contradict the separate personality of corporates and the limited liability of shareholders, and is therefore recognized by most international bodies.

#### **4. How to Hold Parent Companies Liable against the background of Globalization**

##### **4.1. Home Countries**

At present, there are clearer standards for the jurisdiction of transnational tort litigation against MNEs, and tort litigation involving parent companies is generally accepted by the courts of the MNEs' home country. The approach of pursuing the parent's tort liability through the determination of its duty of care to the subsidiary, although being in accord with the provisions of law and capable of regulating the parent company's unlawful acts, faces challenges due to the growing number of cases concerning the wrongful acts of MNEs around the world. There are different standards and considerations for the determination of duty of care in different countries, and conflicting precedents within countries further complicate the matter. As a result, there is a great deal of uncertainty when courts adjudicate such cases, and the rights of the victims cannot be adequately and promptly remedied. This underscores the necessity of establishing a clearer and more uniform definition of the criteria for determining the duty of care and allocating the responsibility to prove in such cases.

##### **4.1.1. Duty of Care**

Current judicial practices in the United Kingdom, France and Switzerland shows that the standard to determine duty of care varies from country to country. The UK courts are more concerned about the parent's relationship with the subsidiary and victim, and whether the parent could reasonably foresee the wrongful acts of its subsidiary. Articles 4 and 5 of the French Commercial Code directly stipulate parent's duty of due diligence of towards its controlled subsidiaries, as well as the duty of care to the casualty in case the breach of this duty results in damage caused by the illegal act of the subsidiary. In the Swiss legal proposal, a parent should monitor the activities of its units around the world in order to prevent wrongful acts that bring destruction to the environment or violate human rights, or else be directly liable for the wrongdoings of its subsidiaries [14]. The following factors should be considered when judging if a parent has a duty of care for the illegal acts of its overseas subsidiaries:

First, the degree of control of the parent over the subsidiary (proximity). As the controlling shareholder of the subsidiary, the holding company is usually able to control the production and operation of its unit. However, in terms of determining the duty of care, the parent group's control of its subsidiaries needs to reach the degree of "effective supervision, control or intervention". There is no need to prove that the parent company had taken over business related to the wrongful act [15].

Second, whether the illegal act committed by the subsidiaries is foreseeable for the parent (foreseeability). Foreseeability includes whether the parent knew or should have known that the subsidiary may engage in wrongful acts causing damage, and whether they were aware of the risks associated with the subsidiary's production and operation, as well as the necessity for the subsidiary to rely on the parent's product or technology to mitigate those risks. Foreseeability emphasizes the idea that the parent company was informed or should have been informed that a detrimental result might occur but did not take appropriate measures to avoid it.

Furthermore, the causation between the damage and the parent's neglecting its duty of care(causality). A parent company could be exempted from liability if it could prove that it had exercised reasonable care but still failed to prevent its subsidiary from committing an offence that had caused the damage.

Finally, the principle of fairness and reasonableness should be considered. In order to avoid unreasonably increasing the duty of care of parents to their units worldwide, specific cases should



take into account the regulation of illegal acts of MNEs and the rights and interests of the host states or their nationals, while following the basic principle of fairness and reasonableness [16].

#### **4.1.2. Burden of Proof**

As can be seen from the case law in UK, the victim bears most of the burden of proof in such cases, thus usually end in failure due to the inability to provide sufficient evidence. Specifically, the victim is usually required to prove the existence of the close tie between the parent and subsidiary, the causation between the parent's failure to exercise duty of care and the harmful consequence and so on. In order to better balance the burden of proof between the prosecution and the defense in these cases, the Swiss proposal can be drawn upon. The plaintiff (i.e., the victim) bears the burden of proving the control relationship between the two and the fact that the subsidiary committed tortious act that caused the damage. The defendant (parent company) is obliged to prove that it had fulfilled its duty of care towards its subsidiary reasonably, otherwise it would be found directly liable to the victim [14].

#### **4.2. Possible Solutions for Host Countries**

The host country also needs to make efforts to safeguard the rights and interests of its own country and nationals. First of all, they should refer to the legal policies of developed countries with regard to the regulation of MNEs, formulate and implement their own laws at home, gradually expand their jurisdiction over such cases, and build up a more improved and stronger legal system in that area [17]. This will not only help to safeguard the rights and interests of the country, but also do good to the protection of local enterprises and the development of the economy. Furthermore, the role of international organizations, for example, the United Nations and the OECD, can also be brought into full play. Through the conclusion of multilateral treaties, promote fairer transnational trade and require MNEs to comply with commitments related to human rights and environmental protection. Lastly, a dispute settlement mechanism for MNEs centered on international organizations can be gradually founded, such as establishing national contact points in home and host countries, so that when tort lawsuits related to MNEs occur, international organizations can provide advisory opinions and organize compulsory mediation [14]. The efforts of host states are not only crucial to the protection of its own existing interests, but also significant to its subsequent development as well as to the healthy development of global investment and trade.

### **5. Conclusion**

In the context of the further development of economic globalization, MNEs occupy an important position in the global market and have a significant impact on host states' economy, politics and many other aspects. However, because of state interest considerations and the profitability of the company, it is common for subsidiaries of MNEs to commit illegal acts in host states, infringing upon the rights and interests of the host states or their nationals. Through the study of the current judicial practice of countries around the world, this paper further clarifies the parent's responsibility for the damage induced by the unlawful acts of its overseas subsidiaries. Particularly in the aspects of specific principles, considerations and burden of proof. Due to the control relation between the parent and its subsidiaries, the parent usually has negligent liability for damages caused by its subsidiaries when it fails to fulfill its duty of care. This depends on whether the parent owes a duty of care and the relationship between duty of care and damage caused by the illegal act of the subsidiary. By analyzing the specific rules for determining parent company's liability, promote fairness, rationality and standardization of the adjudication of such cases, and help to achieve a balance between the parent's responsibility and the protection of rights. The international community has yet to form rules and a

unified mechanism for processing cases of infringement by MNEs so far. The world is moving further toward globalization, so it is essential for the international community to establish a fair and reasonable mechanism for resolving the issue of infringement by MNEs, so as to better achieve healthy development of the global economy and the goals of public policy.

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