

**BRIEFING PAPER FOR CONSULTATION:
Parent Company Liability**

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for the ESCR-Net & FIDH Joint [Treaty Initiative Project](#)

Context

There are a numbers of reasons why it becomes necessary for the victims to sue parent companies for human rights violations committed by their subsidiaries.¹ For example, the victims may not understand complex corporate structures or may not see any real distinction between the parent and its subsidiaries in view of intertwined decision making processes. In some other instances, a subsidiary may lack financial resources to compensate adequately all the victims. Alternatively, the legal system of the country where a subsidiary is incorporated may not provide victims a robust basis to hold the said company accountable.

However, whenever the victims try to sue parent companies in view of the practical or legal necessities alluded above, parent companies invariably rely on two principles of corporate law: ‘separate corporate personality’ and ‘limited liability’.² The principle of separate corporate personality means that a company is an *artificial* legal person separate from its shareholders, directors and executives.³ One of the results of this legal separation is that a parent company is generally not liable legally for the conduct (both acts and omissions) of its subsidiaries. On the other hand, the principle of limited liability limits the liability of a shareholder for the corporate conduct to the extent of its investment in the given company.

The twin principles were developed during a period when ordinarily only human beings could be shareholders in companies. This meant that unless authorised by a specific charter issued by the Queen/King, artificial legal entities like companies were neither allowed to hold shares in other companies nor could companies establish their own subsidiaries.⁴

¹ Surya Deva, ‘Corporate Code of Conduct Bill 2000: Overcoming Hurdles in Enforcing Human Rights Obligations against Overseas Corporate Hands of Local Corporations’ (2004) 8 *Newcastle Law Review* 87, 97-99; Amnesty International, *Injustice Incorporated: Corporate Abuses and the Human Rights to Remedy* (London: Amnesty International, 2014), 117-18.

² Parent companies also rely on the doctrine of *forum non conveniens*. But that legal issue is not covered in this paper.

³ There are different theories explaining or justifying the idea of separate corporate personality, e.g., legal fiction, state concession, aggregate, natural entity, and the nexus of contracts. See David Millon, ‘Theories of the Corporation’ (1990) *Duke Law Journal* 201.

⁴ Phillip Blumberg, *The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality* (New York: Oxford University Press, 1993), 52.

These corporate law principles have served a useful purpose in that they encouraged investment, innovation and the spirit of entrepreneurship. However, the twin principles also had a negative effect: over a period of time, parent companies started to rely on these principles as a ‘shield’ to deny, avoid or delay legal liability for human rights violations by their subsidiaries. Such a shield would be effective unless courts disregard the separate personality of a subsidiary company by lifting the corporate veil on certain limited grounds.

Unpacking the problems

Courts have developed several exceptions to the principle of separate corporate personality:⁵ the corporate veil may be pierced if the court finds that a given subsidiary is a sham or a puppet of the parent company in view of the extensive control exercised by the latter over the subsidiary. The veil may also be pierced if a subsidiary is used by the parent company to commit fraud, avoid tax or for some other illegal purposes.

In practice however it is not easy for the victims to pierce the corporate veil and hold a parent company accountable for human rights abuses committed by its subsidiary. Courts tend to expect a very high degree of proof in satisfying the threshold of control to lift the corporate veil. Another key hurdle is posed by the unprincipled, incoherent and unpredictable exercise of judicial discretion in piercing the corporate veil.⁶ Then there is the problem of inefficiency: whether the corporate veil could be lifted or not is known on a case by case basis after a long vexatious litigation over this procedural issue. Studies have also pointed that the corporate veil is pierced less often (i) in tort cases as compared to contract disputes and (ii) in situations when the shareholder behind the veil is an individual instead of an artificial company.⁷

In short, as parent companies ordinarily keep ‘distance by design’ from their subsidiaries, it is almost impossible for the victims to hold parent companies accountable for of corporate human rights violations. The legal idea of separate corporate personality, thus, does not really match with the economic reality of multinational corporations (MNCs) or the social perception about them. Consequently, if the proposed treaty has to make a positive difference to the situation of impunity enjoyed by parent companies, it must find a way to minimise the corporate misuse of the twin principles of corporate law as a matter of routine.

Potential options for the OEIGWG

There are at least four options how the open-ended intergovernmental working group (OEIGWG) could deal with the obstacles posed by the twin principles of corporate law in holding a parent company accountable for human rights violations committed by its subsidiaries. It should be noted that these options are proposed *only* in relation to ‘civil liability’ of companies, as different considerations apply regarding criminal liability.

⁵ Paul Davies, *Gower and Davies’ Principles of Modern Company Law*, 7th edn. (London: Sweet & Maxwell, 2003), 181-90.

⁶ Dan D Prentice, ‘Veil Piercing and Successor Liability in the United Kingdom’ (1996) 10 *Florida Journal of International Law* 469, 474; Frank H Easterbrook and Daniel R Fischel, ‘Limited Liability and Corporation’ (1985) 52 *University of Chicago Law Review* 89.

⁷ Robert B Thompson, ‘Piercing the Corporate Veil: An Empirical Study’ (1991) 76 *Cornell Law Review* 1036, 1038, 1056, 1068-9.

- A. Specify and Clarify Corporate Veil Piercing Exceptions:** As the exceptions to corporate veil piercing are fairly common and well-established across various jurisdictions, the proposed treaty may require states to provide a statutory recognition to these exceptions and also clarify the circumstances in which each exception could be satisfied.

This option should be easy to implement as the exceptions are widely recognised, judicially or in a statutory form, in both common law and civil law countries. The treaty could make one key improvement in the current situation by specifying circumstances under which such exceptions could be satisfied by a plaintiff. Having said this, this option might not prove very much beneficial to victims of corporate human rights abuses: despite specification of the variables of each exception, litigation in each case and uncertainty in judicial interpretation would be inevitable. Corporate lawyers may also advise companies in advance on how to operate in such way that the exceptions to the corporate veil are not attracted.

- B. Recognise the Principle of Enterprise Liability:** Under this option, the treaty may encourage states to recognise all companies of a group as one ‘enterprise’ for the purposes of litigation involving human rights. This would avoid the need for litigation as to whether the corporate veil should be lifted or not, thus bringing more legal certainty for all parties.

While the enterprise principle is recognised by some states in certain situations, this is more like an exception than a norm. Hence, this option is likely to face resistance from states as well as business enterprises, among others, on the ground that the adoption of enterprises principle would nullify all the advantages of the principles of separate corporate personality and limited liability. This option, which would bring legal reality of corporate groups closer to their economic reality, will be clearly advantageous to victims as compared to Option A. This option should also encourage companies of a group to consider human rights issues more holistically for the entire group, rather than move risky or hazardous businesses to distant or under-funded subsidiaries.

- C. Statutory Adoption of the Direct Duty of Care Approach:** Courts in the UK (and Australia) in certain cases⁸ have held that a parent company may owe a direct duty of care to its subsidiary’s employees in certain circumstances.⁹ If the conditions to invoke the direct duty of care principle are satisfied, then there would be no need for the victims to pierce the corporate veil in order to target the parent company.

⁸ *Chandler v Cape plc* [2012] EWCA Civ 525; *Connelly v Rio Tino Zinc Corporation* (1999) CLC 533; *CSR v Wren* [1997] 44 NSWLR 463. See also Richard Meeran, ‘Tort Litigation against Multinational Corporations for Violation of Human Rights: An Overview of the Position Outside the United States’ (2011) 3 *City University of Hong Kong Law Review* 1, 7-10.

⁹ In *Chandler*, the court laid down these circumstances as follows: ‘Those circumstances include a situation where, as in the present case, (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.’

If the direct duty of care is accorded a statutory recognition, this should be beneficial to victims as compared to proving any of the exceptions to the separate corporate personality under Option A. However, it would be critical that the application of the direct duty of care principle is not limited to workers: rather its protection should be extended to all people affected by the conduct of subsidiaries. Otherwise this option will have a very limited scope and beneficial impact.

- D. Raise Rebuttable Presumption about the Liability of a Parent Company:** Under this option, the law could raise a ‘rebuttable presumption’ about the liability of a parent company for human rights violations by its subsidiaries as a matter of legal principle. The parent company will be liable unless it can show that it did not know (or had no reasons to know) about the human rights violations in question, or that the violations took place despite the parent company taking appropriate preventive and redressive due diligence steps.¹⁰

One obvious advantage of this option over Option C will be that the victims would need to merely establish breach of human rights violations linked to the activities of the parent and/or subsidiary company. Once the injury and causation are established, the burden will shift on the parent company to demonstrate that either it had no knowledge about human rights abuses committed by its subsidiary or that violations took place despite the parent company adopting reasonable due diligence measures. Similar to Options B and C, business enterprises are likely to resist against a legal recognition of such a presumption of responsibility. It should be noted though that as compared to Option B (enterprise principle), Option D will be better for companies too, as this would not result in an automatic liability for the conduct of their subsidiaries.

From the victims’ perspective, it appears that Option D should be most useful. However, considering that the proposed international treaty would apply to states with different legal systems and diverse regulatory approaches, it may be desirable to provide states with a few options – such as Options B, C and D canvassed above – as long as they could overcome the well-documented hurdles in access to justice.¹¹ Whichever of these options are adopted, the principle of ‘joint and several liability’ should also be applied.¹² Doing so would allow a parent company to compensate all the victims in the first instance and then seek contribution from its subsidiaries, if necessary.

¹⁰ Although the Guiding Principles on Business and Human Rights do not explicitly prescribe due diligence responsibility in the context of parent-subsidiary companies, there are strong reasons to imply this responsibility both in relation to subsidiary companies of a corporate group and independent contractors.

¹¹ See, e.g., Phillip Blumberg, ‘Asserting Human Rights against Multinational Corporations under United States Law: Conceptual and Procedural Problems’ (2002) 50 *American Journal of Comparative Law* 493; Deva, ‘Overcoming Hurdles’, note 1; Amnesty International, *Injustice Incorporated*, note 1; Jennifer Zerk, *Corporate Liability for Gross Human Rights Abuses: Towards a Fairer and More Effective System of Domestic Law remedies*, a report prepared for the Office of the UN High Commissioner for Human Rights (2013).

¹² This tort principle implies that all wrongdoers are responsible both jointly and individually to pay the entire compensation amount.

Specific Questions for CSOs/Victims

CSOs are invited to provide comments and suggestions or raise questions about any issue relating to this briefing paper. To facilitate this process of informed engagement, a few illustrative exploratory questions are listed below:

- 1) Do you see companies of a corporate group as separate legal persons or not?
 - 2) Why should a parent company be accountable for human rights violations committed by its subsidiaries?
 - 3) How is it beneficial for victims to sue parent companies, which are often located in overseas jurisdictions?
 - 4) Did you ever try to make a parent company legally liable for the wrongful conduct of its subsidiaries? If so, (i) what step did you take, and (ii) what difficulties, if any, did you encounter?
 - 5) If the law made parent companies legally accountable for the behaviour of their subsidiaries, would it not discourage corporate innovation and investment?
 - 6) Any other comments or suggestions that you may have?
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