

DRAFT: NOT YET FOR CIRCULATION

Corporate Liability for Wrongdoing within Subsidiaries:

Mechanisms from Corporate Law, Tort and Regulation

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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 proposals on foot which, if adopted, 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 papers 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. In the course of this development, the default position of asset partitioning within groups of companies has been (or will be) significantly qualified, at least in relation to tortious (delictual) liability.

1. 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

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

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 flip side of asset partitioning. 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 under regulation, but tort victims whose claims exceed value of the company's assets fall into the same category. Despite the support for this qualification from the authors of the asset partitioning analysis, it has gained little traction in doctrinal reform in any jurisdiction I am aware of. Their proposal that shareholders should be liable for torts committed by companies

² P Davies, *Introduction to Company Law*, 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*, 2018.

in which they were invested sought to meet the obvious objections by basing shareholder liability for the amount the company could not itself meet, not on a joint and several basis, but on the basis of liability proportionate to the shareholding.⁵ Nevertheless, on the one hand, procedural obstacles to the enforcement of the shareholders' liability remained,⁶ while, on the other, alternative mechanisms outside corporate law are available to address the corporate deficit. 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 unable to meet in full a judgment against them are limited companies.

The second qualification, whilst also supporting the counter-externalisation argument, 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.⁷ For example, the benefits in terms of reduced monitoring 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,⁸ 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

⁵ Liability on a joint or several basis would make the value of the shares dependent, inter alia, on the wealth of the other shareholders. This would both cut against the trading of shares on a public market at a uniform price which reflected the economic prospects of the companies, and give shareholders an incentive to hold shares via judgement-proof entities or persons.

⁶ R Romano, *Foundations of Corporate Law*, 1993, 81-83.

⁷ Above n 4.

⁸ 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.

liability for subsidiaries' debts in exchange for greater formal control over the subsidiaries' decisions by the parent board.⁹

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*¹⁰ 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."¹¹

2. The issue in tort law

The parent's duty of care accepted in principle

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. In *Chandler v Cape plc*¹² 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 on the

⁹ 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 (forthcoming). The best known example of this approach is German "group law", under which the parent is granted the 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, it is not obvious that doing what the parent requires is contrary to the interests of the subsidiary. See *Charterbridge Corporation v Lloyds Bank* [1970] Ch. 62.

¹⁰ [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.

¹¹ 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.

¹² [2012] EWCA Civ 525, CA.

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.

"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*¹³ for the recognition of a duty of care in situations not 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

¹³ [1990] BCLC 273, HL.

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*¹⁴ 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.”¹⁵ He approved the approach of Sales LJ (as he then was) in *AAA v Unilever plc*¹⁶ 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.”¹⁷ 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*.¹⁸

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 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).¹⁹ The subsequent cases, *Vedanta*, *AAA* and

¹⁴ [2019] UKSC 20

¹⁵ At [56].

¹⁶ [2018] EWCA Civ 1532.

¹⁷ At [36].

¹⁸ [2021] UKSC 3 at [24] - [25].

¹⁹ The subsidiary in fact had been dissolved, but presumably it could have been restored to register, had its insurance policy been of any value.

Okpabi, all involved foreign subsidiaries of an English parent company, which carried on substantial continuing businesses in their respective jurisdictions.²⁰ 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.²¹ Although too polite to mention it, the claimants may have felt also that they would be likely to obtain a more favourable 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.²²

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 Regulation²³ 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 elsewhere.²⁴ 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

²⁰ Zambia, Kenya and Nigeria, respectively.

²¹ 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].

²² See further below the discussion of host state involvement in human rights abuses.

²³ Art. 4 of the Recast Brussels Regulation on Jurisdiction etc in Civil and Commercial Matters, Regulation (EU) 1215/2012.

²⁴ 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.

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.²⁵ Perhaps in all contexts, the question of whether an issue is triable or arguable faces the court with a difficult issue about how far to go in exploring the underlying factual and legal issues in order to decide a preliminary issue. In *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.²⁶

What does "ordinary" tort law require?

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.²⁷ 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,

²⁵ CPR, Pt 6, Practice Direction 6B, para. 3.1.

²⁶ In *Vadanta* 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 18).

²⁷ 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.

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.²⁸ 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;
- (4) The parent holding out that it exercises a particular level of control over the subsidiary.

In *Opkabi*²⁹ the court’s view was that there was an arguable case under both headings (1) and (3). In *Vedanta*³⁰ 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 (publicly traded companies at the 3% level and above

²⁸ 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.

²⁹ At [153].

³⁰ At [61].

and at the 25% level in nearly all cases).³¹ 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 the dissemination of the policies 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.³²

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"³³ UK companies, includes "non-financial" information on:

- Environmental matters (including the impact of the company's activities on the environment)³⁴;
- 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

³¹ *Gower Principles of Modern Company Law*, 11th ed, 2021, paras 27-011ff, 13-022ff and 28-024 (this last dealing with the disclosure of "control arrangements").

³² At [133] to [140].

³³ I.e. officially listed in the UK or an EEA state or traded on the NYSE or Nasdaq.

³⁴ In the case of climate change disclosures the CA's requirements are enhanced by the Listing Rules (LR 9.8.6(8)).

risks.³⁵ Reputational incentives are likely to encourage large publicly traded companies to adopt policies rather than report that it had no such policies.³⁶

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.³⁷ In *Opkabi* the Court of Appeal, although 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.”³⁸

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 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.”³⁹ 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.⁴⁰ 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).⁴¹

³⁵ CA 2006, s 414CB (operative from December 2016).

³⁶ See further below at ???

³⁷ At [61].

³⁸ At [111].

³⁹ Company Law Steering Group, Final Report, 2001, Vol. 1, 3.40.

⁴⁰ CA 2006, s 496.

⁴¹ CA 2006, s 463. Directors’ liability to persons other than the company is excluded entirely.

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 website, 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 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.⁴²

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*,⁴³ 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 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.⁴⁴

⁴² See further the discussion below at

⁴³ [2018] EWCA Civ 1532.

⁴⁴ 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).

3. 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 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 company should be subject to legal incentives to exercise a proactive control over subsidiaries and contractors so as to reduce the risk that human rights violations will be committed by 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 tort theory leaves the parent with more freedom than this third theory to craft intra-group functions as it wishes. First, under the 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). By contrast, under modern human rights proposals, a blue-print is developed 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. 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,⁴⁵ 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 wrongs falling under the third theory, which are derived under the EU proposals from standards of human rights and environmental protection found in international treaties and conventions, are not fully congruent with the wrongs covered by the law of negligence. For example, a negligent harm inflicted on a single employee in a one-off event could normally not be brought within the scope of the international standards. However, the situations where the parent company is most likely to be found to owe a direct legal duty to third parties 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.

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.⁴⁶ The report led initially to the UN's *Guiding Principles on Business and Human Rights*, 2011,⁴⁷ 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 which would make human rights standards embodied in international treaties and conventions directly and legally binding on companies. These international instruments had previously

⁴⁵ 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.

⁴⁶ Available at media.business-humanrights.org/media/documents/files/reports-and-materials/Ruggie-report-7-Apr-2008.pdf.

⁴⁷ United Nations, Office of the High Commissioner on Human Rights, 2011 (HR/PUB/11/04).

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 incorporate or the state of operation had ratified and implemented effectively the international agreements.⁴⁸

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 Diligence⁴⁹ is important. The Commission's draft is heavily influenced by that of the working group, perhaps not surprisingly in view of the Commission's membership of the group. If adopted, it will pre-empt the decisions of the Member States whether to sign the document which emerges from the working group, by making its underlying ideas mandatory within the EU and the international standards binding on companies via the "due diligence" obligation.

More important, it will 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 on 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."⁵⁰

⁴⁸ For the working group's latest draft of 2021, see www.ohchr.org/sites/default/files/Documents/HRBodies/HRCouncil/WGTransCorp/Session6/LBI3rdDRAFT.pdf

⁴⁹ 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)

⁵⁰ Commission Staff Working Document, *Impact Assessment Report*, 23.2.2011 (SWD(2022) 42 final) para 6.1.5.

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 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 (only) 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 identifies 20 human rights provisions and 12 environment ones in relation to which the company must perform due diligence, but point 21 of Section 1 of Part 1 of Annex A throws in *en gros* a further 22 Human Rights Conventions without identifying particular provisions within them with which it is appropriate to require companies to comply.

Due diligence

The central element in the proposal is the duty on the companies falling within its scope to carry an assessment of the human rights and environmental risk contained in its established business relationships and to take step to prevent those risk 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.

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 annually 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 (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 its 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 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 (Art 22). This Article is unclear about the extent to which Member States have simply to apply their own civil liability rules to breaches of Arts 7 and 8, except for two points where the Article does make specific provisions. First, the company has a no-negligence defence where the harm was caused by an entity in the value chain with which the company did not have a direct relationship. Second, Member States must provide that their national rules transposing Art 22 have “overriding mandatory application”, thus excluding arguments that the law of the subsidiary’s jurisdiction is the applicable law.

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.

Figure 1

	Incorporated in EU	Incorporated in Third Country
General Rule	500 employees + €150m turnover world-wide	€150m EU

“High Risk Sectors”	250 ees + €40m ww (50% high risk)	€40m EU (50% of ww turnover 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 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.”⁵¹

While the principle of applying human rights law to companies incorporated outside the jurisdiction but carrying on business within it seems 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.

Companies or groups?

The criteria for inclusion within the Directive apply on a company-by-company basis, not to groups as whole. If a group consists of companies which individually fall below the criteria but the group as a whole exceeds them, the Directive will not apply to any of the group companies. Or if one of the group companies only meets the criteria, the Directive will apply to its value chain but not the value chains of the other group companies (assuming the chains are distinct). At first sight, this is very odd, since there can be hardly any large businesses which do not consist of groups of companies; and in many cases the group’s business policies map rather imprecisely onto the underlying corporate structure. Moreover, the company-by-company

⁵¹ S 54(12).

approach generates certain possibilities for opportunism. Take a group containing a number of EU subsidiaries of various sizes. The parent might be tempted to divert a proposed new investment away from a subsidiary which lay just below the threshold for inclusion and to divert it instead to one which was far below the threshold – or even to one which had crossed the threshold and so had already incurred the costs of complying with the proposed Directive. The company-by-company approach also risks the creation of bureaucratic costs for companies. A group with in-scope subsidiaries within a number of separate EU member-states will have to deal with an equal number of regulatory authorities, which may follow somewhat differing paths. This may create incentives for companies to consolidate their EU subsidiaries within a single corporate vehicle, perhaps in the process breathing some life into the under-used European Company.

The main advantage of the company-by-company approach is that it facilitates simplicity of drafting. In particular, the EU-segment of a large multinational group headquartered in the EU would have to be distinguished from the non-EU segment, since only companies incorporated or trading in the EU may be subject to the due diligence obligation, without unacceptable extraterritorial impact. While this might be straightforward where the group consists of a singly chain of wholly-owned subsidiaries and sub-subsidiaries, it would be difficult to draft rules to segment a complex group with relationships on a horizontal as well as on a vertical dimension and with partial as well as fully owned subsidiaries and affiliates.

4. Two fundamental questions about due diligence obligations

Why do companies breach human rights and environmental standards?

We noted above the economists' take on externalities. Like most economists' models, this one is "parsimonious" because that facilitates the analysis of the data available. So, in this model, the company shifts costs onto third parties or, if they naturally fall on third parties, the company leaves them there, because this reduces the company's costs of production and thus increases its (operational) efficiency. In a competitive market, companies are no doubt incentivised to reduce their costs of production, and so to take advantage of externalities, so as to maintain or strengthen their competitive position. It follows from this analysis that efficiency from a societal point of view requires some mechanism whereby those costs are taken into account by the company when calculating its costs of production.⁵² However, there may also be

⁵² As Coase famously point 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.

constraints on the willingness of senior management of large companies simply to trample on the human rights of others or degrade the environment in the name of operational efficiency. The weight of these competing arguments 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.⁵³ 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 two main explanations for the adoption by large US companies of non-binding international standards are 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; 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;⁵⁴ and customer-facing companies may suffer a backlash from consumers if their record in these areas is poor. Moreover, provided all companies comply with the international standards, the competitive 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."⁵⁵ If supported, the argument does not remove entirely the case

⁵³ 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)

⁵⁴ 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.

⁵⁵ *Regulatory Scrutiny Board Opinion, Proposal for a Directive . . . on Sustainable Corporate Due Diligence*, SEC(2022) 95, 26.11.2021, p 1.

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 the international standards, 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*, 2011,⁵⁶ and the OECD's *Due Diligence Guidance for Responsible Business Conduct* (2018),⁵⁷ which are linked to the OECD's *Guidelines for Responsible Business Conduct* (2011),⁵⁸ 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, the Commission proceeded with the proposal anyway.⁵⁹

How to cope with state complicity in human rights abuses?

The previous section does not purport to argue 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 of the relevant operations of the group 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.”⁶⁰

The reported cases from around the world give support to this statement. In *Kiobel v Royal Dutch Petroleum Co*⁶¹ the allegation was that the Nigerian government engaged in violent suppression of Nigerian communities protesting against pollution resulting from a pipeline

⁵⁶ 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 ??) and is not to be confused with the binding Treaty which the Working Group of the Human Rights Council has developed (above n ???).

⁵⁷ mneguidelines.oecd.org/mneguidelines/

⁵⁸ doi.org/10.1787/9789264115415-en

⁵⁹ 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).

⁶⁰ Above n ?, para 16.

⁶¹ 569 US 108 (2013), US Supreme Court.

operated by Shell. (The Court held the claim did not fall within the Alien Torts Statute.) In *Nevsun Resources Ltd v Araya*⁶² 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 held by a local state-owned company (which is common) or through lucrative contracts linked to the multinational's business.

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*⁶³ 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*,⁶⁴ 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

⁶² 2020 SCC 5.

⁶³ Above n 18.

⁶⁴ Above n 16.

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 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 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. The Recitals 32, 36 and 41 to the proposal state that exit should be a "last-resort" action, but this is true only in the sense that exit is placed at the end of the list of actions the proposed Directive *requires* of companies. But, as a commercial matter, exit is always available to companies. 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*⁶⁵ 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 company 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.⁶⁶ There is nothing in either

⁶⁵ 16 February 2022, "How Unilever's tea business became a test of private equity's conscience".

⁶⁶ 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.

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.⁶⁷ 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 "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.⁶⁸

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*⁶⁹ 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

⁶⁷ "Vedanta's London exit fails to stem scrutiny of Indian miner", *Financial Times*, October 17, 2018.

⁶⁸ 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).

⁶⁹ 141 S Ct 1931 (2021).

administrative fines and civil damages for 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.”

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. And that voice is likely to have to be, not that of the company alone, but part of a cooperation among the company, the host state, local communities and the overseas development agencies of the consuming countries, as in the Nestlé case. A company playing its part in the cooperation should be granted protection against both litigation and supervisory action. 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’s 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.”⁷⁰

In short, the liability rules contained in the proposed Directive appear to be a standard, backward-looking set of provisions for imposing liability on companies, not a blue-print for cooperative efforts to end abuses in the future. In the most difficult cases where it is most desirable to alter behaviour, exit is what the Commission’s proposal is likely to induce, with uncertain or no benefits for the victims of the abuses.

⁷⁰ Above n 55, p 4.

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 loses its complete freedom of action in this regard.

Consequently, in this area 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 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 argument⁷¹ 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. It is true that neither set of rules is formally confined to groups of companies. The UK tort rule turns on the exercise of control over the hazardous activities of a company. This is most likely to impact on the parent or some other company in a corporate group, but the control basis of liability could stretch to a non-group company or entity to which the parent had outsourced the control function. Sales L J recognised this when he drew the parallel between the parent's liability and that of a consultant giving advice to the subsidiary.⁷² As to the EU proposals, we have noted above that formally the due diligence obligation attaches to companies which meet the relevant size thresholds, whether they are members of a group or not, and, even if they are not, they must still carry out a due diligence exercise in relation to their own operations.⁷³ Nevertheless, given the size criteria, the companies caught by the proposals will overwhelmingly be members of groups and the parents of such groups will have value chains which embrace at least some other members of the group.

Despite these extensions, the crucial point from the perspective of unlimited liability for corporate torts is that, if 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. The rules are about expanding corporate liability for torts and breaches of international standards committed by others, not about the implementation of a general policy of shareholder liability for corporate torts. This might suggest that the rules considered in this paper score more highly as an implementation of the Hansmann and Squires' proposal⁷⁴ 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 only a partial implementation of the Hansmann and Squires proposal as well.

⁷¹ Above n 1.

⁷² Above, text attached to n 17.

⁷³ Art 6.

⁷⁴ Above n 4.

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 analogous) 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 subsidiaries, with the consequent risk that harm caused by the subsidiaries' activities will be externalising onto third parties. Those third parties will be left without redress to the extent that their claims exceed the subsidiary's equity or to the extent that redress is not in fact available in the jurisdiction where the harm occurred. In addition, there will be inefficient over-production of the good or service in question.

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 production process. 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 or to assert that they do so, even in the absence of a due diligence duty.

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 permit the top company to exercise control over contractors via a contract with the direct contractor (rather than by direct instruction) and then relieve the company from damages liability if the terms of the contract are not complied with by an indirect partner, unless it was unreasonable for the company to expect that the contract would be ineffective.⁷⁵ 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

⁷⁵ Arts 7(2)(b), 8(3)(c) and 22(2).

contractors.⁷⁶ Again, it is possible that this contrast with the tort rules is less important than it seems. 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 liability in relation to subsidiaries may apply there as well. The parent would then fall, in relation to the contractor, into the same category as the consultant identified by Sales LJ.⁷⁷

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 by companies whose parents are domiciled in jurisdiction subject to the due diligence obligation rather than any significant alleviation of the position of those abused. Of course, setting the appropriate standard for parent company conduct arises in the first form of the duty, but at least 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.

⁷⁶ See Alessio Paccas, "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).

⁷⁷ Above, text attached to n 727.

