PARENT COMPANY LIABILITY

When does parental control become too much?

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UK-headquartered multinational companies face the increased risk that non-UK claimants may be able to bring claims against them in the English courts for the overseas acts of their non-UK subsidiaries. There is an increasing trend for these claims, particularly in relation to environmental and human rights issues.

The English Supreme Court recently gave judgment in Vedanta Resources PLC and another v Lungowe and others [2019] UKSC 20. The case confirmed that a duty of care can exist between a parent company and third parties affected by the operations of its subsidiaries.

The case adds pressure to multinationals to manage risks effectively across their corporate groups and supply chains. A failure to mitigate these risks could create legal liability for multinational parent companies, result in litigation and cause significant harm to the reputation and brand of the wider corporate group.

The cases

Vedanta is one of three recent and high-profile jurisdictional cases – all of them procedural decisions of the English courts about whether they have jurisdiction to hear a claim. All three have been decided at appeal level; Vedanta is the first of the three cases to reach the Supreme Court (the highest appellate court in England and Wales).

The jurisdictional rules and analysis applied by the courts are outside the scope of this article. But the crucial point is that for the purpose of confirming jurisdiction in these cases the courts have had to grapple with, and answer, the question of whether or not there is at least an arguable duty of care between an English-domiciled parent company and third parties affected by the acts of an overseas subsidiary of the parent, such that a claim can proceed to a full substantive trial on the merits in the English courts.

Vedanta

In the Vedanta case, 1,826 Zambian villagers brought proceedings in the English courts against Vedanta Resources Plc, a UK incorporated parent company and Konkola Copper Mines Plc (KCM), its Zambian subsidiary, claiming that waste discharged from a copper mine owned and operated by KCM had polluted the local waterways, causing personal injury as well as damage to property and loss of income.

In 2016, the High Court held that the claimants could bring their case in England, even though the alleged harm occurred in Zambia, where both the claimants and KCM are domiciled. This

LIABILITY OF A UK PARENT
Courts have taken a harder look at the governance process at multinationals

decision was upheld on appeal by the Court of Appeal in October 2017 and again by the Supreme Court which gave its decision in April of this year. The Supreme Court judgment means that the claim can now proceed to a full substantive trial.

Shell and Unilever

In 2018 two similar cases were heard by the English Court of Appeal. The cases involved:

- Royal Dutch Shell Plc (Shell) – two Nigerian communities are claiming against Shell and its Nigerian subsidiary, Shell Petroleum Development Company of Nigeria Ltd (SPDC), a joint venture with Nigerian shareholders and the Nigerian government, for oil spills from SPDC-operated pipelines
- Unilever PLC (Unilever) – 218 Kenyan nationals are claiming against Unilever and its Kenyan subsidiary Unilever Tea Kenya Limited, the owner of a tea plantation in Kenya, at which the claimants allegedly suffered ethnic violence at the hands of third-party criminals

In both cases the Court of Appeal concluded that there was not an arguable duty of care, in contrast to Vedanta.

The Supreme Court's decision in Vedanta: key points

The Supreme Court confirmed that there was nothing legally novel about the parent/subsidiary relationship that requires a special test or set of factors for deciding parent company liability for the acts or omissions of a subsidiary. The key test for parent liability will be one of corporate control: did the parent company have superior knowledge and expertise regarding, and control over, the subsidiary's operations?

As this was a jurisdictional challenge and not a full trial on the merits, the Supreme Court held that the claimants needed only to show that a duty of care was 'arguable', which meant persuading the judge that a sufficient level of intervention by Vedanta in the conduct of operations at the mine may be demonstrable at trial, after full disclosure of the relevant internal documents of Vedanta and KCM, and of communications passing between them.

The Supreme Court refused to be drawn on setting prescriptive principles or an exhaustive list of factors and circumstances in which an arguable parent company duty of care might arise, pointing out the futility of confining the court's inquiry too narrowly. Given the typical complexity of modern corporate structures, and that there is no limit to the models of management and control used within multinational groups of companies, the Supreme Court emphasised that the existence of parent company duties of care is a question of fact in each specific case. These comments will no doubt be of concern to multinationals wishing to understand in exactly what circumstances a parent company might attract liability for its subsidiaries' activities.

In fact, the Supreme Court rejected the Court of Appeal's attempts in the Shell and Unilever cases to categorise or in any way prescribe the circumstances in which a parent will owe a duty of care to persons affected by a subsidiary:

- The Supreme Court cast doubt on the suggestion of the Court of Appeal in the Shell case that, as a general limiting principle, a parent company could never incur a duty of care for the activities of a subsidiary simply by establishing group-wide policies and expecting the management of each subsidiary to comply with them
- The Supreme Court expressed reluctance to shoehorn all cases of parental liability into specific categories of the kind suggested by the Court of Appeal in the Unilever case. These two categories were: (i) where the parent has in substance taken over the management of the relevant activity of the subsidiary in place of or jointly with the subsidiary's own management; and (ii) where the parent has given relevant advice to the subsidiary about how it should manage a particular risk

Instead, the Supreme Court simply clarified the factors that might support establishing a parent company duty of care in specific circumstances.

The case for establishing parental liability in Vedanta

Although Vedanta did not have material control of the mine's operations, the Supreme Court held that the claimants' case on Vedanta's duty of care was arguable. The claimants had identified multiple circumstances that indicated that Vedanta had superior knowledge and expertise regarding, and control over, KCM's operations. In particular, Vedanta had:

- Published a public sustainability report, which stressed that the oversight of all Vedanta's subsidiaries rests with the board of Vedanta itself and made express reference to the particular problems at the mine in Zambia
- Entered into a management and shareholders' agreement by which Vedanta had a contractual obligation to provide KCM with various support and supervisory functions »

- Provided detailed and specific health and safety and environmental training across the Vedanta group
- Provided extensive financial support for KCM
- Made various public statements regarding its commitment to address environmental risks and technical shortcomings in KCM's mining infrastructure
- Exercised a high degree of control over KCM's operational affairs

The Supreme Court weighed up these various factors to decide whether the alleged duty of care was reasonably arguable. The Supreme Court noted that Vedanta's assertion in published materials of its own assumption of responsibility over the activities of KCM and the operations of the mine was particularly damning. So too, according to the Supreme Court, was the fact that Vedanta had not simply laid down proper standards of environmental control over the activities of its subsidiaries and, in particular, over the operations at the mine, but that it had gone further by implementing those standards through training, monitoring and enforcement.

What are the implications for UK parent companies?

The Vedanta case represents a clear widening of the circumstances in which a parent company could be said to owe a direct duty of care to people affected by the operations of a subsidiary. The Court of Appeal in Shell and Unilever tried to frame specific categories of corporate management, control and advice that will or won't be deemed to create parent company liability; the Supreme Court rejected those attempts.

It is likely that the factors identified by the Supreme Court will be heavily relied on by claimants in future cases in an attempt to establish parent company liability. But don't panic if any of these factors are familiar to you and your company: the existence of similar factors in another corporate group, in relation to a different claim, is not necessarily determinative. The English courts take a holistic view – no single factor or combination of factors will determine the existence of a parent company duty of care, rather the totality of circumstances surrounding the parent company's relationship with its subsidiary and its role in the specific operations of its subsidiary giving rise to the claim in issue will be relevant.

The Vedanta case therefore raises inevitable concerns about whether or not multinational companies are structured and operating in a way that could give rise to parent company liability.

It is, of course, impractical to restructure an entire corporate group in reaction to a single case. In any event, the fact-specific and non-prescriptive guidance of the Supreme Court prevents any certainty that particular structures would necessarily avoid findings of parent company liability.

Nevertheless, a rule of thumb for parent companies seeking to avoid liability for the operations of their subsidiaries is that they should, where practicable, seek to maintain clear operational division between their activities and the activities of their subsidiaries. There are various ways in which the risk of a finding of parent company liability could, depending on the circumstances, be avoided:

- Strong subsidiary governance whereby directors of local subsidiaries exercise independent judgment and the board of a subsidiary controls its direction (this is less straightforward for businesses organised by activity or region than for businesses organised by legal entity)
- Drafting public statements and reports to avoid any implication of parent company responsibility for the individual application by subsidiaries of relevant, group-wide standards
- Considering which framework policies are in place and how they are communicated, monitored and enforced – in particular, parent companies should take care not to take responsibility for the individual implementation of those policies by their subsidiaries at a local level

Even these measures present some challenges for parent company boards exercising normal group oversight, where compliance failures of one group company adversely affect the group.

Conflict between parental liability and business and human rights?

A question for multinationals will be their approach to implementing group-wide policies, for instance about Modern Slavery or Pillar II of the UN Guiding Principles on Business and Human Rights (UNGPs), which provides a framework for businesses to prevent and address negative human rights impacts. The UNGPs are currently voluntary and companies may be deterred from taking steps to respect human rights because of a perceived risk of parent company liability. However, there is clearly a tension here: there is no better solution for avoiding parent company liability than ensuring that risks are effectively mitigated through appropriate on-going due diligence and company-level grievance mechanisms. And, careful drafting can produce policies that make it clear that the implementation, administration and standard of care imposed by those policies are the sole responsibility of the subsidiary. A policy does not automatically establish parental liability over outcomes which are not within that parent company's control.

It would be a bitter irony if the English courts' willingness to hear claims against English-domiciled parent companies for the operations of their overseas subsidiaries indirectly led to reduced engagement by these companies with human rights, environmental and/or HSSE concerns.

Looking forward

This Supreme Court decision makes clear that parent companies/multinationals can have liability for the overseas operations of their subsidiaries. Although this is a decision turning on the specific facts of the Vedanta case, those facts are by no means unique: we anticipate that this decision is likely to encourage equivalent claims to be brought.

The date of the substantive trial of Vedanta has not yet been listed. The Supreme Court has recently refused the claimants' application for permission to appeal the Court of Appeal judgment in the Unilever case. This is the end of the line for the claimants in that case. The claimants in the Shell case have recently been granted permission to appeal the Court of Appeal judgment in their case to the Supreme Court. A decision on that application is expected shortly. Accordingly, this area of law is far from settled and will continue to be the subject of intense scrutiny. The Vedanta, Shell and Unilever cases are highly fact-specific and are only responding to jurisdictional challenges at this stage. The appeal of the English courts to overseas claimants is ultimately likely to depend on how their claims are treated, and whether an actual (rather than merely arguable) parent company duty of care is established, once these parent company liability cases are considered on their merits.

The Vedanta case represents a clear widening of the circumstances in which a parent company could be said to owe a direct duty of care to people affected by the operations of a subsidiary

A major concern expressed by corporates has been the perceived risk of a floodgates moment if parent company liability to third parties is established in any of these cases. Conversely, a number of human rights activists and specialist claimant firms have advocated for a generous application of the law: as a matter of public policy, why shouldn't multinational parent companies be held to account for the operations of their subsidiaries, they say, particularly where justice is hard to obtain in the country where their subsidiary, which has caused the alleged harm, is located?

Will a full trial in the Vedanta case be that floodgates moment? Only time will tell.