

Research on MNE Liability for Environmental Damage Caused by Subsidiaries

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Abstract: Lawsuits against multinational enterprises (MNEs) due to environmental torts committed by their subsidiaries are increasing. Case law indicates that the direct reason for holding parent companies liable for the environmental torts of their subsidiaries is the duty of care that parent companies owe to their subsidiaries. The paper aims to analyse the logic behind MNEs being held liable for the environmental torts of their subsidiaries. The paper will analyse the reasons for imposing a duty of care on MNEs, the standards for holding MNEs liable through the duty of care, and the allocation of the burden of proof in environmental tort litigation. The paper employs a combined analysis of statutory law and case law. The conclusion drawn is that it is lawful and reasonable for MNEs to be liable for the environmental torts of their subsidiaries, but the boundaries of such liability need to be clearly defined, and the allocation of the burden of proof should be inclined towards the injured parties.

Keywords: MNE liability, duty of care, environmental damage, burden of proof.

1. Introduction

Economic globalization has been driving overseas investment. Increasing enterprises set up their subsidiaries overseas. The growing number of MNEs and their subsidiaries is causing numerous litigations for overseas environmental damage, which further raises the question of whether MNEs should be liable for their subsidiaries' environmental damage. In January 2019, 1,826 Zambian farmers' appeal against Vedanta Resources plc ("Vedanta") was heard in the United Kingdom Supreme Court (UKSC). The appellants brought their claim against Vedanta and its subsidiary Konkola Copper Mines ("KCM") which was domiciled in the Chingola District in Zambia[1]. Their claim was based on tort negligence with the reason that "KCM had been emitting toxic substances from the Nchanga Copper Mine from 2005 to date, causing environmental and health problems, and Vedanta had a very high degree of interference in the operation of its subsidiary"[1]. In this case, the court held that Vedanta shall be liable for the environmental tortious liability of its subsidiary KCM, therefore the UK courts have jurisdiction over the case which occurred in Zambia. This is a milestone case emphasizing MNEs' liability for the actions of their subsidiaries[2]. Similarly, in June 2020, *Okpabi and others v Royal Dutch Shell Plc* and another was heard in the UKSC. The appellant claimants pleaded an arguable case that the Royal Dutch Shell Plc ("RDS") owed them a common law duty of care on the negligent oil spill of its subsidiary, the Shell Petroleum Development

Company of Nigeria Ltd (“SPDC”)[3]. In Okpabi case, the UKSC decided that the UK courts should exercise jurisdiction over the case applying the principles established in the Vedanta case.

However, as existing precedents do not thoroughly argue the underlying logic for holding the parent company and the fairness problems of the burden of proof, this paper will analyse the reasons and situations to hold MNEs liable for subsidiary actions. Consequently, the paper follows the following line of thinking: First of all, it focuses on the legal basis of MNEs being liable for environmental torts committed by their subsidiaries based on the duty of care theory. At the same time, it is necessary to clarify the boundaries of the duty of care that MNEs owe in the field of transnational environmental liability, that is, under what circumstances can a MNE be deemed to have failed to fulfill its duty of care, and thus must bear liability for the environmental torts of its subsidiaries. Additionally, this paper also plans to argue from the perspective of the burden of proof issue about how the burden of proof for the duty of care of parent companies should be allocated.

The paper, on the one hand, will clarify the liability of MNEs for the actions of their subsidiaries in environmental tort cases, better balance the interests of MNEs and the injured parties, ensure fair resolution of environmental disputes, and make international trade more efficient. On the other hand, the paper proposes ways to legally bind MNEs, which will encourage them to fulfill their commitments and reduce the occurrence of environmental damage incidents.

2. The Legal Basis for Parent Liability for Environmental Damage Caused by Subsidiaries

Case law stipulates that the type of liability that MNEs bear is a violation of the duty of care. The concept of the duty of care originates from corporate law and tort law. In environmental tort cases, the application of the duty of care differs from that in general tort cases. The paper will next clarify the legal definition of duty of care in corporate law and tort law and its application patterns in environmental tort litigation.

2.1. Concept of Duty of Care in Corporate Law and Tort Law

The concept of duty of care is primarily involved in corporate law and tort law. In corporate law, duty of care requires directors to exercise a certain degree of attention to corporate affairs. The level of attention should be the same as that displayed by a reasonably prudent person under similar circumstances. More specifically, directors are not only expected to avoid negligence and exercise proper supervision and management when making decisions, but also to actively strive for the interests of the company. As the individuals managing the actual affairs of the company, although directors owe fiduciary duties to the company and its shareholders, their obligations to shareholders are indirectly fulfilled through the legal entity of the company. This means that shareholders typically cannot directly sue directors for negligent actions unless such actions have caused harm to the company[4]. The duty of care in corporate law leans towards regulating the management responsibilities of directors and protecting the interests of the company.

By way of contrast, the duty of care in tort law focuses more on regulating the actions of individuals or organizations and protecting the rights of the party who has suffered damage. In the field of tort law, as mentioned in the Restatement (Third) and the Place of Duty in Negligence Law, duty, breach, causation and injury constitutes the theoretical basis of negligence claim[5]. The injury involved is usually not difficult to prove. Once the breach of duty is established, the issue of causality becomes much easier to resolve. Therefore, the core of theoretical analysis should be focused on the origin and content of the duty. The Restatement (Second) of Torts states that “the individual must act in a specific way, understanding that failure to comply could result in legal responsibility towards someone else to whom the duty is owed, for any harm they suffer that is legally attributable to the individual’s behavior[5]. A claimant must illustrate that the defendant should have taken reasonable

care to avoid the foreseeable injury but failed. The boundaries of such duty are greatly influenced by the public awareness of the precautionary caring duty, as Lord Atkin once said: “The concept of negligence liability is rooted in a societal consensus that there is a moral wrong in the offender’s actions, and compensation is necessary to achieve justice[6].” Additionally, when the act of taking reasonable care is far from sufficient to prevent the occurrence of harm, strict liability should apply, and the negligence rule no longer serves as a defense. That is, regardless of whether the defendant has fulfilled the duty of care, he or she should be held liable for the damage caused. Strict liability provides solid protection for trade security[7].

2.2. Duty of Care is the Legal Basis of MNE Liability for Environmental Tortious Acts of Subsidiaries

Corporate law stipulates that a company is independent of its shareholders and is an entity capable of conducting activities and assuming liabilities on its own[8]. As a result of shareholders’ overseas investments, a subsidiary is an independent legal entity. Additionally, according to case law, the interests of a company are distinct from the interests of the group to which it belongs. A subsidiary has its own separate interests and can prioritize them over the interests of the parent company[9]. Based on the independence theory of the subsidiary, it is difficult to hold MNEs liable for the tort of their subsidiaries.

Nevertheless, in environmental cases, the losses caused are relatively huge. If the MNE is not held liable, due to undercapitalization and other limitations, the subsidiary’s liability for compensation often fails to be effectively enforced. This could not only severely impact the livelihoods and even the daily lives of those individuals who have been harmed, but also have a significant negative impact on the economy of the host country. Additionally, MNEs often have significant control over their subsidiaries. If the parent company is not held liable, it may have an attempt to evade responsibility.

At the same time, one of the most significant purposes of MNEs in establishing subsidiaries is to alleviate financial risks and increase profits. As a result, they are often reluctant to spend time and money to supervise the actions of their subsidiaries. In the face of substantial compensation claims against a subsidiary, they often engage in asset restructuring to give the appearance of the subsidiary being undercapitalized, in an attempt to minimize the amount of compensation paid[10]. Claimants also faces high litigation fees and a disadvantage in respect of the burden of proof. Under normal circumstances, the court should demand MNEs to disclose their relevant documents in order to alleviate the inequity caused by unequal ability to proof[11].

Therefore, MNEs should be held liable for environmental torts committed by their subsidiaries. However, as they are separate entities, it is unfair to require the parent company to bear liability in all circumstances. Case law in the UK has shown that the core of such issues lies in the degree of actual intervention by the parent company in its subsidiary, which is a question of fact. In the Vedanta case, Lord Briggs argued that the case was not about a new category of negligence, but about the duty of care stipulated by common law. The defendant had failed to fulfill the duty of care under common law, thus there was indeed a real issue to be tried against Vedanta. The extent of Vedanta’s intervention in KCM’s operations determined whether Vedanta had a duty of care. The evidence provided by the plaintiff indicated that Vedanta publicly claimed to have set standards for mine operations and claimed to supervise its subsidiaries. Additionally, the plaintiff also argued that the management services agreement between Vedanta and KCM indicated a close relation between the two. Lord Briggs argued that Vedanta’s supervision and control over its subsidiary were quite evident, which persuasively demonstrated that Vedanta was aware of KCM’s polluting practices and knew that such practices would cause environmental harm. Failing to actually supervise its subsidiary in these circumstances, Vedanta should be regarded as having violated the duty of care and should be held liable for KCM’s environmental torts[1]. It can be concluded that the duty of care under common

law depends on the MNE's direct control over the subsidiary, the MNE's indirect control over the subsidiary through the implementation of group policies, and the MNE's public statements of assuming environmental responsibility. MNEs, with businesses spread overseas, enjoy brand effects and profits from affiliated activities but rely on subsidiaries to evade liability, which does not align with the public consensus on fairness[12].

3. Application of Duty of Care Principles in Environmental Tort Cases

In the Vedanta case, the UKSC outlined four principles for holding MNEs liable for environmental responsibilities, known as the "Vedanta routes." It is important to note that these routes are adjusted according to the circumstances of different jurisdictions and cases. However, these routes reflect the principles by which the UK courts recognise the duty of care responsibility of MNEs.

According to paragraph 3.1(3) of the Civil Procedure Rules Practice Direction (CPR PD), a tort claim within the UK jurisdiction must fall within the following gateways: First, there is a real issue for the British court to try. Second, the defendant is a necessary or proper party to the claim[13]. The plaintiffs need an anchor to establish a connection between the actions of the parent company and the damage they have suffered, thereby making this issue an arguable one in the English forum. In Vedanta case just mentioned, the court further examined the duty of care issue and clarified and refined the "extent and manner" of parent control, forming four routes to hold the MNE parent liable:

- a. MNE parent co-managing the relevant activities of the subsidiary.
- b. MNE parent offering guidance and/or establishing group safety/environmental policies adopted by the subsidiary.
- c. MNE parent not only setting group-wide safety/environmental policies but also actively ensuring their enforcement by the subsidiary.
- d. MNE representing that it maintains a specific level of supervision over the subsidiary[1].

The first and second pathways both refer to the direct management of subsidiaries by the MNE parent, such as co-managing and offering guidance. The direct control actions of the parent company are relatively clear and unambiguous, and there are generally no disputes in the definition. The challenge to this principle is: MNEs may reduce their control over subsidiaries and increase the independence of subsidiaries to reduce the likelihood of taking responsibility. This issue can be easily resolved: on the one hand, in the Okpabi case, direct control was given a narrowed interpretation, making it more difficult to meet the condition of MNE parent control[14]. On the other hand, if in the corporate governance structure, the subsidiary is too independent and the parent company neglects management, it will affect the company's ability to attract customers, which will be further discussed in the fourth pathway.

The second and third pathways propose that the injured party must prove that MNEs not only established group-wide safety/environmental policies but also ensured the implementation of these policies. This principle is relatively vague. The environmental damage suffered by different injured parties vary greatly, making it difficult to establish a connection between the policies and specific damage. For example, in *Ogiale v. Shell*, the plaintiff lost the case because they could not prove the causal relationship between the damage and the defendant's specific actions[15]. Furthermore, the principle stipulates that the parent company must actively ensure these policies. However, this raises the issue of how to interpret insurance. MNEs can claim that subsidiaries did not truly implement these policies in actual operations due to the countless links in the corporate operation. This imposes an excessively high burden of proof on the injured party. The issue of the burden of proof will be discussed in the next part. The definitional issue of insurance leads to a fruitless debate between the plaintiff and the defendant. An effective solution is to change the way MNEs are held responsible by incorporating the environment as a stakeholder and establishing eco-liability for MNEs. Clarkson defines stakeholders as "individuals or groups who have, or claim to have, an ownership interest in a

corporation and its activities, past, present, or future[16].” The environment does not transact directly with the company but has a significant impact on the company’s business strategy and interest and can be considered as a secondary stakeholder[14]. Holding companies directly responsible for the objective negative impact of their environmental policies on the environment is easier to implement than requiring the plaintiff to prove the causal relationship.

The fourth route stipulates that MNEs represent a certain degree of supervision over their subsidiaries. This principle focuses on protecting the injured party’s trust in the goodwill of MNEs, while, as mentioned earlier, holding MNEs liable for the benefits brought by their subsidiaries. In the Vedanta case, the existence of an internal sustainability report was one of the important reasons for holding Vedanta liable[1]. As plaintiffs engage in transactions with MNEs based on trust in their promised supervisory systems, it is fair and reasonable to make MNEs pay for their breach of trust.

4. Inversion of Burden of Proof

The plaintiff’s use of the law to attack the defendant is an act of self-defence. The plaintiff needs to use evidence to give the court reason to believe that there is a certain relationship between the plaintiff and the defendant, thereby allowing the adjudicator to make a ruling. The act of offering evidence to the court is the burden of proof[17]. The legitimacy of the evidence submission process is an important condition for achieving procedural justice. Under different factual circumstances of the case, the burden of proof is allocated differently between the plaintiff and the defendant. The parties’ prior knowledge of how the burden of proof is allocated may make a difference in if to file a lawsuit and has a significant impact on the litigation process. When the burden of proof is reversed, the defendant bears a heavier burden of proof. That is, the defendant needs to prove that they have done something or have actively taken action to prevent the occurrence of something[18]. In cases of environmental torts involving MNEs, the inversion of the burden of proof is necessary. When the existing scientific evidence does not reasonably establish a causal relationship between an action and damage, the burden of proof may be reversed. More specifically, if one party has conducted a risk assessment on potential serious environmental issues and taken certain preventive measures, but the other party has not implemented preventive actions or is unable to refute the preventive actions taken, the burden of proof may be reversed[18].

On the one hand, those who have suffered environmental damage face difficulties in providing evidence. When proving the existence of environmental damage, they often confront high appraisal fees. For example, the Niger Delta region suffers from extreme poverty, and in proving pollution by hydrocarbons, it is necessary to rely on professionals and specialized equipment. The United Nations Environment Program has stated that the assessment fees should not be entirely borne by the injured parties in the Niger Delta region[15]. If the quality of evidence is to be improved, the plaintiff must bear high costs, which is a second blow to the financial situation of the damaged area.

On the other hand, to prove the MNE’s liability, evidence must be provided of the parent company’s direct control over the subsidiary, the MNE’s policies, and the implementation of these policies. This evidence, which is necessary to prove the existence of a duty of care, relies on internal documents that can only be obtained after the company discloses them. Under the UK law, subsidiaries are not mandatorily obligated to disclose information about their operations[19]. The plaintiff clearly has less access to information and is in a disadvantaged position. Consequently, a reasonable solution should be to stipulate the inversion of the burden of proof in advance or to require MNEs to disclose internal documents during the litigation process. By way of contrast, for the defendant, the burden of proof is relatively easier to meet. MNEs, as experienced commercial entities, possess ample funds and a variety of access to information, and thus seldom face difficulties in providing evidence. Considering the disparity in the capabilities to proof between the two parties, it is equitable to assign the majority of the burden of proof to MNEs. Reducing the burden of proof for

the injured party can enhance their expectations of success in litigation, encouraging them to protect their rights and interests against the infringing actions of MNEs.

5. Conclusion

After analysing the concept of the duty of care, its legal basis in tort law, and its application in environmental litigation, the following conclusions can be drawn: Firstly, the duty of care indicates a significant progress in legislation which prevents MNEs from using the independence of corporate personality as a “shell” to evade responsibility. Secondly, the principles of applying the duty of care in environmental litigation are generally reasonable. However, courts can further stipulate whether to impose eco-liability on MNEs and the application of shifting the burden of proof. The significance of this thesis lies in protecting the rights of the injured parties, providing MNEs with a more stable expectation when investing overseas, and maintaining the fairness of environmental litigation involving MNEs. Given the situation of the increasing impact of environmental quality on the sustainability of economic development, future research can further explore the eco-liability of MNEs, considering the value of the environment as a shareholder. The implementation of the reversal of the burden of proof is a safeguard for the rights of the injured party and at the same time a safeguard for procedural justice. Even if environmental damage does occur, the injured parties have avenues to seek compensation.

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