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Limited liability and multinational enterprises: a case for reform?

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In the context of corporate groups, the legal principles of limited liability and corporate separation can lead to injustice in cases of harm to involuntary creditors by externalising risks that ought to be internalised by the enterprise as the better risk taker. The avoidance of responsibility can be achieved by interposing a separate legal entity between the victims and the ultimate controller of the group, be it a parent company or its controlling shareholders. The resulting lack of legal responsibility could be remedied in a number of ways ranging from adaptations of existing exceptions to the doctrine of limited liability to outright abolition of limited liability. Preference is given to a statutory principle of enterprise liability for the controlling entity. The implications of these doctrines are also discussed in relation to the choice of jurisdiction in which to bring a legal action.

Key words: Corporations, Limited liability, Multinational enterprises, Risk allocation, Involuntary creditors
JEL classifications: F20, G30, K20

1. Introduction

The principle of limited liability appears indispensable to the proper operation of corporations in the market. Given its capacity to reduce investment risk through the separation of corporate assets and those of its owners and promoters, limited liability is said to encourage entrepreneurship, to reduce monitoring costs for investors and creditors and to ensure the promotion of the market for corporate control by reducing the cost of shares (Easterbrook and Fischel, 1985; Cheffins, 1997, pp. 499–504). Notwithstanding these economic benefits of limited liability, this paper argues that the doctrine needs to be restricted where it is used to shield the owners and controllers of a company against liabilities to third parties, where justice requires that such liability be preserved. In particular, the use of limited liability to shield multinational corporate groups from liability for personal injuries caused by their overseas operations is examined.

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Accidents and injuries arising out of the operations of multinational enterprises (MNEs) pose a major problem for the effective development of the global economy and society. In particular, the capacity of MNEs to organise their legal form in such a way as to avoid responsibility for harm caused to the victims of such events is a cause for concern. In the context of corporate groups, the avoidance of responsibility can be achieved by interposing a separate legal entity between the victims and the ultimate controller of the group, be it a parent company or its controlling shareholders. Such a use of corporate separation can also be used to 'hide' the controlling enterprise from being present in the jurisdiction where the harm has occurred, thereby making litigation against it harder. Though in legal terms such devices are entirely normal and useful for the control of investment risks they are also likely to externalise other risks, in particular risk of harm, in morally and socially unacceptable ways.

This paper seeks to highlight the shortcomings of this situation, first by considering the development of limited liability and corporate separation in company law, emphasising the very specific circumstances in which these risk-limiting devices were initially meant to operate. Second, by showing how the development of modern corporate group structures has fundamentally altered the assumptions of risk allocation embedded in early law and has created a rift between the legal entity and the underlying economic enterprise leading to the unsatisfactory allocation of risk between the enterprise and those harmed by its activities. In this context some of the most important legal cases concerning group liability will be examined to reinforce the critical position that this paper takes. Finally, the paper concludes by considering alternatives to limited liability in the case of harm caused to victims. The recommended solution is not the complete abolition of limited liability and corporate separation in group enterprises but the introduction of a statutory principle of enterprise liability for torts.

2. The nature of limited liability and corporate separation in company law

Limited liability arose in the nineteenth century as a result of a political and economic struggle designed to stimulate economic activity by encouraging widespread investment in corporate shares (Blumberg, 1986, p. 604, and see further: Blumberg *et al.*, 2005). It was not an integral part of the corporate legal form as such. Limited liability was first discussed in England, with a view to its introduction into law, by the Bellenden Ker report on partnership law of 1837. There the French system of *societes en commandite* was reviewed. Under this system only those with direct control of the undertaking were fully liable for its debts and obligations while those who put up the capital were liable only to the extent of their contribution. However, no recommendation for the adoption of the French system was made (Hadden, 1977, p. 20). A series of further reports considered the introduction of limited liability, or the adoption of the French system, but none was able to recommend its introduction. The risks of limited liability were seen as too great to permit its general availability as a matter of law. Despite this the government pressed on to adopt limited liability (Davies, 1997, pp. 41–3).

In 1855 the first Limited Liability Act was passed. This contained a number of stringent conditions for the granting of limited liability, including requirements as to the number of members—at least 25—the extent of paid up capital, the use of the word 'limited' in the corporate title and the personal liability of directors if they paid a dividend knowing the company to be insolvent or if they made loans to the members. However, in 1856 the Act was repealed and incorporated into the 1856 Joint Stock Companies Act with most of the earlier restrictions removed. All that was necessary was for seven or more persons to sign and register a memorandum of association (Davies, 1997, p. 45).

Thus, from the outset it was clear that limited liability created the possibility of an externalisation of risk, and this led to the initial hostility to the idea and to the introduction of restrictive conditions in the 1855 Act.[1] However, the political decision to allow for limited liability under law allowed for a deregulated form of limited liability. In the nineteenth century the implications of this approach were ignored as the need for limited liability as a device for the reduction of investment risk was perceived as paramount. In this the 1856 Act appeared to have worked. Indeed, soon after its passage the number of incorporations grew at a staggering pace.[2]

The main policy reason for the adoption of limited liability was to ensure the availability of capital for major industrial developments such as the building of railways though the narrower objective of protecting *rentier* investors has also been proposed as an explanation for its introduction (Ireland, 2008). What is clear is that limited liability served to protect individual investors who might otherwise face personal ruin if they were faced with unlimited liability. This coincided with the growth of modern mass stock markets comprised of large numbers of small investors as well as larger investment entities, though the kinds of large institutional investors common in today's market were yet to emerge. Indeed many argue that limited liability is essential to the proper functioning of the stock market as its absence can undermine clarity in the valuation of companies' assets given increased uncertainty over exposure to, and liability for, risks, particularly tort risks (Hansmann and Kraakman, 1991, p. 1903). This may lead to excessive monitoring of corporate behaviour by shareholders and to increasingly risk-averse investment strategies on their part (Cheffins, 1997, p. 499; Mendelson, 2002, p. 1217).[3] Thus, the absence of limited liability could have led to a reduction of capital available for investment during the crucial phase of modern economic development in the second half of the nineteenth century even if the price was to create a *rentier* class of passive shareholders.

In analysing the origins of limited liability, the relationship between limited liability and bankruptcy should also be noted. During the 1840s the UK economy experienced a boom followed by a collapse leading to an increased demand for bankruptcy regulation. This was provided by a series of Winding-Up Acts passed between 1844 and 1849. In the absence of limited liability shareholders would be personally liable but it would be difficult to ascertain who they were as many would have bought or sold their shares after the main losses had occurred (Hadden, 1977, p. 21). Thus, some way of separating corporate assets and liabilities from those of the shareholders was necessary in order to make the new procedures work. In addition the removal of incorporated companies from the general bankruptcy jurisdiction and handing over jurisdiction to the Chancery Court under the process of liquidation created a closer relationship between insolvency issues and corporate

[1] For a strong contemporary critique of the externalisation of business risk and, in particular, of personal liability for injury through the introduction of limited liability see Cox (1856, p. ii–vii). Cox states at p. v: 'There is a large class of liabilities known to the law as *wrongs*, which in the course of business are often done accidentally, but for which the law nevertheless, makes to doer answerable in damages, such as a stage coach killing a passenger, a ship running down another, undermining a house and so forth. For none of these acts will a Limited Liability Company be responsible beyond the amount of its shares subscribed, even if action should be brought; but practically no person will bring an action against a Company from which he can recover nothing.'

[2] Between 1844 and 1856, 956 companies were incorporated under the 1844 Joint Stock Companies Act, which did not permit limited liability. After 1856 at least 2,479 companies were registered with a paid up capital of over £31 million (see Davies, 1997, p. 46 n. 64).

[3] See further Leebron (1991), who urges caution before jettisoning limited liability for this reason.

separation of assets. In this situation to have incorporation without limited liability ceased to be logical (Gower, 1979, p. 43; Davies, 1997, p. 40)

Finally, the investment risk-limiting effect of corporate separation and limited liability was reinforced by two important developments in Anglo-American company law at the end of the nineteenth century (Thompson, 2005, p. 620). First, the affirmation of the doctrine of corporate separation and limited liability in the English House of Lords case of *Salomon v Salomon* (England and Wales House of Lords, 1897) allowed private actors to organise their business through the corporate legal form, even though the enterprise was composed of the entrepreneur and members of their household alone, and so was not strictly a true joint stock enterprise but a sole trader who would, up to that point, have been personally liable to all creditors.[4] Such a choice was acceptable, even though it increased the risk of default to creditors on the basis of the right of the entrepreneur to choose the best means of organising his or her business. This was compounded by the increased absence of any direct responsibility of shareholders for the management of the company (Ireland, 2008).

Second, the ending of the prohibition on holding companies paved the way for the rise of modern corporate groups. The first US state to allow for such arrangements was New Jersey, which passed an amendment to its corporation law permitting inter-corporate stock ownership in 1889 (Blumberg, 1986, p. 607). In England case-law established that where a company's articles of association permitted the ownership of shares by that company in another company, this was not prohibited under the common law or the Companies Acts (Blumberg, 1986, p. 608). This development effectively extended limited liability to the corporate group as a whole, creating a new layer of limited liability between levels of corporate ownership, allowing protection not only to the owners of the parent company but also to the parent company in relation to the acts of its subsidiary.

3. The impact of corporate group structures on limited liability and corporate separation

The classical model of the limited liability joint stock company assumes that the owners are actual persons who require the corporate form to engage in the risks of business. It does not contemplate the situation where one company owns and controls another. This creates particular problems in relation to one class of actors: tort victims, who are often referred to as '*involuntary creditors*' of the company that has caused them injury. They have no chance to bargain with the corporation over the allocation of risks, unlike voluntary creditors, who enter into contracts with the corporation (Hansmann and Kraakman, 1991, pp. 1920–1). Yet they may have to bear the risk of loss if the corporation does not possess sufficient assets to compensate them for their injuries. This is due to limited liability, which allows only the actual capital of the company to be used to compensate tort victims. The assets of the shareholders can only be touched up to the extent of the value of their shares in the company.

Where the controlling shareholder is another company, it too benefits from limited liability in the same way as an individual shareholder. However, this may lead to significant under-compensation of tort victims, or even no compensation if the parent has used the separation between itself and its subsidiary to insulate itself from liability.

[4] In practice sole traders will usually be required to give a personal guarantee of their own assets to secure loans to their company thereby limiting the value of limited liability in relation to the creditor offering the loan. However, this is a matter of contract between the trader and the creditor and does not undermine the legal effect of the corporate form for sole traders in their dealings with third parties nor the status of such third parties as unsecured creditors in case of insolvency.

In such cases it may only be possible to hold the parent liable by showing that it was in actual control of the events that led to the injury and the resulting claims for compensation. It will then be a joint torfeasor with the subsidiary. Such cases are very hard to prove as the parent can claim that its subsidiary is a separate entity over which it has little control, at which point the claimants must show that this is not so. They will not always have the evidence needed for a finding of direct control, which would be in the hands of the parent and subsidiaries.

Such realities have led to the gradual development of a new approach to groups based on an enterprise analysis. This is distinct from the formal entity based approach of classical Anglo-American company law. Enterprise analysis seeks to go beyond the separate entity doctrine and look at the underlying economic reality of the group enterprise. It is a form of relational law in that the legal effects of group behaviour are not determined by the contractual relations of individual corporate actors with third parties but by the status of the third party in relation to the group as a whole (Blumberg *et al.*, 2005, Vol. 1, para. 6.03). In this context corporate separation and limited liability ceases to be significant as the basis for determining group liability (Strasser, 2005, p. 661). Of greater significance is the relationship of control and coordination of economic activities between parent and subsidiaries. Where this exists then the group as a whole can be seen as the repository of obligations to third parties and the intervention of corporate separation falls away (Blumberg *et al.*, 2005, Vol. 1. para. 6.02).

An enterprise based approach can allow for the correction of any undesirable externalisation of risk from the group as a whole through reliance on corporate separation and limited liability. It can also allow for a broader approach to the doctrine of ‘lifting the corporate veil’, which is the only significant doctrinal concession to this problem in classical Anglo-American corporate law. Under this doctrine the courts have accepted that in certain specific cases the separation between the corporation and its owners can be disregarded. Mostly these cases involve the use of the corporate vehicle as a means of fraud where it is little more than a ‘sham’ or a ‘facade’ (Davies, 2008, p. 202). However, following strictly the doctrine in *Salomon’s Case*, the courts are reluctant to go beyond this narrow range of exceptions and prefer to maintain the strict integrity of entity doctrine, as will be further illustrated in the next section.

An enterprise based approach has founded certain statutory inroads into the doctrines of limited liability and corporate separation. For example, in US environmental and employment law enterprise based approaches to establishing liability have been used (Schipani, 2005). But even in such areas the courts have at times applied enterprise analysis reluctantly. Most graphically, in *United States v Bestfoods et al.*, (US Supreme Court, 1998) the US Supreme Court reiterated that the active participation in, and control over, the operations of a subsidiary could not, without more, render a parent liable for the acts of its subsidiary.[5] Under US environmental protection laws, an operator of a polluting facility could be held liable for the costs of cleaning up hazardous wastes at that facility.[6] Such a facility was owned and operated by a subsidiary of the parent. At first instance it was held that the parent was an operator of the facility on the ground that it had selected the subsidiary’s board of directors and had populated the executive ranks of the subsidiary with officials of the parent, and that one such executive had been active in formulating the

[5] This summary of the case is taken from Muchlinski (2007, p. 312–13).

[6] Comprehensive Environmental Response, Compensation and Liability Act 1980 (CERCLA) 42 USCS 9607 (a) (2) s.107 (a) (2).

subsidiary's environmental compliance policy. The Court of Appeal reversed in part, saying that the parent could be liable under a lifting of the corporate veil analysis, which had not been made out on the facts. According to the Supreme Court the general principles that a parent is not liable for the acts of its subsidiaries, and that the corporate veil should only be pierced when the corporate form was being abused for wrongful purposes, should not be rejected. In any case a parent that actively participated in, and exercised control over, the operations of the facility could be held directly liable under the applicable law and so it was not necessary to approach the matter in the manner that the lower courts had done.

More surprisingly, as will be shown more fully in the next section, in relation to tort liability enterprise analysis has made virtually no impact. According to US studies, veil piercing is least likely in such cases (Thompson, 1991, p. 1058; Thompson, 2005, p. 632). It appears that here courts are unwilling to second guess risk allocation that has been determined by the group on the basis of the legal impact of corporate separation, which allows for the insulation and 'parcelling' of the capital and other assets of the group into separate legal entities. Equally, the small number of piercing cases could be the result of most cases being settled out of court and it is only the more marginal ones that go to full litigation. It is in such cases that the courts are least likely to pierce the veil and allow for the recovery of, possibly very large, sums of compensation. However, another plausible explanation is simply one of doctrinal inertia, or 'path dependency' in the law, whereby judicial conservatism does not allow for the rejection of classical doctrine in favour of a more economic and functional 'enterprise' analysis of group operations. Certainly the rejection of the 'economic entity' concept in English veil piercing case-law appears in part to have been so motivated.[7]

4. Limited liability, multinational enterprises and mass torts

The globalisation of business activity through the operations of integrated MNEs creates not only problems of substantive liability being limited by reason of corporate separation, but also creates jurisdictional problems arising out of that separation. This arises out of the mismatch between the territorial scope of state regulatory jurisdiction and the globally integrated organisation of the MNE (see generally Muchlinski, 2007, ch. 4). In economic terms this allows for a further method of externalising risk away from the group, using not only corporate separation but the separation of the global legal order into discrete national and sub-national jurisdictions. In effect the 'corporate veil' is being supplemented by a 'jurisdictional veil' that can be used to limit risk by reason of corporate separation.

In relation to issue of establishing jurisdiction, corporate separation may lead to the fiction that the parent company is not 'present' within the jurisdiction of its subsidiary and so cannot be held to have submitted to the legal system of the host country for the purposes of liability. The English case of *Adams v Cape Industries* (England and Wales Court of Appeal, 1991) illustrates this problem well: a UK based parent company exported asbestos from its mines in South Africa through a sales subsidiary, and subsequently through an independent sales agent, to customers in the USA. Two hundred and five plaintiffs, who had been employees of those US customers, brought an action in the USA against Cape for illness suffered as a result of exposure to asbestos. They obtained a default judgment in Texas. Cape took no part in the proceedings as it had no assets in the USA. The US

[7] See further the cases cited in Muchlinski (2007, p. 315, n.33). On the concept of 'path dependence' in company law see Gordon and Roe (2004, Part I).

plaintiffs brought proceedings in the English courts to enforce the Texas judgment. Cape argued that the jurisdiction of the Texas court was incorrectly asserted as it had no presence in the USA, despite the existence in Illinois of its former sales subsidiary and the sales agent. This argument was upheld by the Court of Appeal. It rejected the plaintiffs claim that the sales subsidiary and Cape were a single economic entity for the purposes of presence in the USA. In addition, it rejected the argument that Cape had attempted to avoid direct liability for asbestos-related claims through the closure of its sales subsidiary and its replacement by the sales agency. The latter was established as a legally independent company by the former president of the subsidiary. The Court was not entitled to lift the corporate veil merely because the corporate structure had been used to avoid liability. The doctrine of corporate separation in *Salomon's Case* was not to be lightly disregarded. The Court of Appeal stated:

> It is not suggested that the arrangements involved any actual or potential illegality or were intended to deprive anyone of their existing rights. Whether or not such a course deserves moral approval, there was nothing illegal as such in Cape's arrangement of its affairs (whether by use of subsidiaries or otherwise) so as to attract the minimum publicity to its involvement in the sale of Cape asbestos in the United States. (England and Wales Court of Appeal, 1991, per Slade LJ p. 1026 c-d)

More recently, in a further series of asbestos-related cases from South Africa involving Cape, the English House of Lords recognised that it may be in the interests of justice to allow overseas claimants to sue before the English courts, in cases where they cannot obtain legal aid in the host country where the alleged injurious conduct took place. However, the case did not sanction direct liability for the parent for the acts of its subsidiary as this was a procedural case dealing with jurisdiction. Significantly, the House of Lords did not overrule an earlier finding of the Court of Appeal that the case should be brought in England as the English based parent may have been directly responsible for the actions that led to the claims being made (*Lubbe et al. v Cape Industries*, England and Wales House of Lords, 2000, and see further: Muchlinski, 2001).

The South African Cape cases involved issues of *forum non conveniens*, which, due to developments in European Community case-law, may now be of historic interest so far as English law is concerned (Muchlinski, 2007, pp. 157–60). However other common law jurisdictions, notably the USA still retain this doctrine as a means of preventing 'forum shopping'. In this regard the separation between parent and subsidiary can be used as the basis for arguing that the case is better heard in the host country as the home country of the parent has only a limited connection with the claim given the separation between parent and subsidiary. In such cases the claimants will have to argue, as they did in the *Lubbe* case, that the parent and subsidiary were acting as one entity for the purposes of the event leading to the alleged tort. The Bhopal case illustrates this problem well. Union Carbide sought to have the case removed from the US courts on the grounds that this was not a convenient forum for the litigation as the accident happened in India, all the evidence and witnesses were there and the Indian courts had the strongest policy interest in seeking a solution to the litigation. The plaintiffs argued that as an integrated multinational the parent company was liable for the accident as it had designed, built and operated the Bhopal plant; accordingly the USA was the proper forum for the litigation. The US courts agreed with Union Carbide and vacated the case to India (Muchlinski, 1987).

Turning to issues of substantive liability, in tort, the parent company can be liable if it is shown that, by its acts or omissions, it was a joint tortfeasor with its subsidiary (Muchlinski, 2007, pp. 310–12). It should be stressed that this is not a case of veil lifting under company law. It is a finding of direct tort liability on the facts of the case. The decision of the US District Court in the *Amoco Cadiz* case illustrates such an approach (US District Court, 1984). The case arose out of the oil spillage caused by the grounding of the tanker, *Amoco Cadiz*, off the coast of Northern France in 1978. French plaintiffs brought claims in negligence against Amoco Transport Co. (Transport), Amoco International Oil Co. (AIOC) and their parent, Standard Oil Co. (Indiana) (now Amoco Corporation), Judge Frank McGarr found, on the facts, that the proximate cause of the grounding and spillage was the failure of the ship's steering mechanism. That failure was attributable to negligence in the design, maintenance and repair of the system, and to negligent crew training, which left the latter unprepared to avoid and remedy such a failure. Judge McGarr then undertook a detailed analysis of the organisation and functioning of Standard's shipping operations. He concluded that both the subsidiaries and the parent company were liable on the basis of their being an integrated multinational corporation and on the basis of the control exercised by the parent over its subsidiaries. (US District Court, 1984, p. 338).

The imposition of liability against the parent on the basis of integrated management can be defended on the grounds that, where decision-making is so centralised that major policies could not have been formulated or put into operation without the direct involvement of the parent company, the parent ought to be answerable. In these circumstances the parent is likely to be aware, or ought to be aware, of the risk to potential claimants of such group actions, and to be sufficiently proximate to hold a duty of care towards them (Muchlinski, 2007, p. 313). This approach has been taken in certain Australian and US cases (Muchlinski, 2007, pp. 311–12).

However, the preponderance of authority is in the other direction, with few cases accepting that the parent will be liable even where there is a high degree of integrated management. A leading example of this judicial conservatism is the Australian case of *James Hardie v Hall* (New South Wales Supreme Court, 1998). The Australian Court of Appeal rejected a claim, for asbestos-related illness, brought by the New Zealand based employees of the local subsidiary of the Australian parent company. Although the judge in the first instance had held that the New Zealand subsidiary and the Australian parent company did owe a joint duty of care to the plaintiffs, on the basis of the actual influence exercised by the Australian parent over the subsidiary, this was reversed on appeal. The Supreme Court of New South Wales held that, despite the evidence of some control and influence over the subsidiary, this was insufficient to justify lifting the corporate veil so as to create a direct duty of care on the part of the parent towards the employees of the New Zealand subsidiary (Muchlinski, 2007, p. 312; see also Kluver, 2005). The abovementioned *Bestfoods Case* is also a good illustration of this dominant approach, the more surprising as it occurs in the context of an enterprise liability based statutory duty.

The fact that most cases under Anglo-American law do not accept an enterprise based approach to liability, notwithstanding the possibility of side-stepping company law with tort law, raises fundamental questions about the proper allocation of risk between involuntary creditors and MNE groups. The cases appear not to consider who the better risk taker should be but simply allow for multiple layers of limited liability to insulate the group as a whole and to externalise the risk on to involuntary creditors, which, according to Philip Blumberg, is 'a consequence unforeseen when limited liability was adopted long before the emergence of corporate groups' (Blumberg, 1993, p. 139).

5. Possible solutions? Alternatives to limited liability and full corporate separation

The foregoing critique assumes that the externalisation of risk from the corporate group to the involuntary creditor is wrong. It is wrong in that the poorer risk taker assumes the burden of the risk, contrary to well understood notions of efficient risk allocation (Mendelson, 2002, pp. 1217–25). That risk is created at the hands of the group that profits from the activities giving rise to the risk. Even where insurance may be available to the involuntary creditor this is not a credible policy alternative to group liability as there is no certainty that involuntary creditors will have adequate insurance, or insurance at all, to cover their risks. They may indeed be unable to gauge the extent of the risk that they undertake as they will not have the same knowledge of the risk as the corporation that operates the enterprise and which may be in a better situation to insure as a result (Hansmann and Kraakman, 1991, p. 1888; Mendelson, 2002, p. 1225). Accordingly a reallocation of risk from the involuntary creditor back to the corporate group would appear correct. In this regard a number of possible legal reforms arise, ranging from modifications of limited liability to its outright abolition.

Under the most conservative approach, limited liability remains as the basic principle of law but lifting the corporate veil should occur where the interests of justice demand it. As noted above, current law only permits this in cases of abuse of the corporate form. This excludes most tort cases where the parent is not directly involved in the course of events leading to the harm but is aware of the general situation, or ought to be so aware, and to act to prevent the harm from materialising. Extending liability to the parent company in such cases should reduce the risk of moral hazard by placing it on notice of possible liability and thereby to encourage greater attention to reducing risk as opposed to externalising it. Equally it would allow for the disregarding of the 'jurisdictional veil' by permitting the court to accept the presence of the parent in the jurisdiction where the harm occurs as a result of its relationship with the subsidiary. Furthermore, in a case such as *Adams v Cape Industries*, it would permit the court to find that the conversion of the sales subsidiary in that case into an independently owned but economically related sales agency (run by the former director of the sales subsidiary) could be disregarded as a 'sham'.

However, veil lifting is a far from perfect solution. It involves judicial discretion and so makes effective management planning harder. It may be difficult to anticipate *ex ante* whether a particular legal form of group organisation will survive judicial scrutiny. Equally judges have differed on such issues even in the same case. After all in *Salomon's Case* the Chancery Court and the Court of Appeal refused to recognise the validity of incorporation by a sole trader and it was only the House of Lords that did so. Similarly in the Bhopal case the US courts did not accept that Union Carbide was an integrated enterprise and that the parent was therefore properly sued before the US Courts whereas, on the same facts, Judge Seth, in the course of interim proceedings in India, held that the corporate veil could be lifted and the parent treated as responsible for the acts of its Indian subsidiary (Muchlinski, 2007, p. 315). Thus, while veil lifting may be an improvement on the present situation of complete irresponsibility (Ireland, 2008, p. 9) it may not reduce the uncertainties and costs of complex fact-specific litigation.

In place of judicially controlled veil lifting it may be possible to introduce a legal presumption of parent responsibility for the acts of the subsidiary based on the actual or potential control exercised by the former over the latter (Mendelson, 2002). The presumption of control gives advance notice to the parent of the risk of liability, and places the onus on the parent to rebut the presumption with conclusive proof of the independence of the subsidiary. In the case of a highly integrated company that presumption may be almost impossible to rebut. However, it may be rebutted where it can be shown that the third party has transacted with the subsidiary in the full knowledge that the parent had expressly excluded its liability. In such a case the third party would qualify as a voluntary creditor as they would have had the opportunity to assess the risk of the relationship with the group enterprise. A presumption of parent liability gives greater clarity as to possible future liability than discretionary veil piercing and it places the burden of showing that the subsidiary is wholly independent from the parent on the latter. That said, in relation to voluntary creditors, it could be easily avoided by a properly worded express exclusion of liability for the acts of the subsidiary. On the other hand, where the third party has reasonably relied on the parent to underwrite the subsidiary's liability, as where the parent has issued a legally effective guarantee of the subsidiary's debts, then even the strongest proof of corporate independence should not excuse the parent.

The value of such a presumption in cases involving involuntary creditors of controlled subsidiaries is that it may be impossible to rebut as, by definition, such creditors would not have had the opportunity to assess risk or to contract with the parent over the allocation of risk. The fact of actual or potential control over the subsidiary would be enough to establish parent liability. In such cases the presumption would amount to an assertion of strict parental liability. In relation to jurisdictional issues such a presumption, if adopted by the home country of the MNE, would provide the required connection between the acts of the subsidiary in the host country and the parent in the home country so as to allow the home country court to assert jurisdiction and to hear the claim. As noted above, such a possibility was recognised by one of the English Court of Appeal decisions in the case of *Lubbe v Cape Industries*, which was not overruled by the House of Lords (England and Wales House of Lords, 2000, Muchlinski, 2001).

A presumption of parent liability based on control over the group could be introduced by judicial development, as in the case of the doctrine of strict 'enterprise liability' created by the Indian courts in response to the Bhopal accident (Muchlinski, 1987; Muchlinski, 2007, p. 314–16). That is, at present, unlikely in Anglo-American jurisdictions and so the alternative would be to introduce parent liability under statute. This could be a statutory exception to the doctrine of corporate separation. The approach is shown in the UK Corporate Responsibility Bill of 2003 where such liability may be introduced by law.[8] One important issue is whether parental liability should be based on a duty of care, requiring proof of negligence on the part of the parent or whether, as in Indian doctrine, it should be strict, arising out of the fact that the parent is the controlling entity in the enterprise. Clearly, the incentive to internalise risk on the part of the parent would be greater if liability was strict. Whatever approach to liability is taken, the major issue in such cases would be to show what the boundaries of the enterprise are for the purposes of liability. Not only the parent but other affiliates might be relevant parties in given cases. This issue is well known in existing law, whether in relation to definitions of holding companies or groups for taxation purposes or for the purposes of group accounts. Equally, *de facto* control tests such as those found in German stock corporation law could be developed to prevent evasion of responsibility through arrangements such as those used in *Adams v Cape Industries* (Blumberg *et al.*, 2005, Vol.1, para. 6.02; Muchlinski, 2007, p. 329). Then the parent's

[8] The *Corporate Responsibility Bill 2003* is available at http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmbills/145/2002145.pdf [date last accessed 28 June 2010].

only defence would be to show that the harm was not caused by enterprise activity but by an intervening external cause to which enterprise responsibility could not attach.

The preceding approaches all build upon exceptions to the doctrine of limited liability and corporate separation—they do not fundamentally challenge them. As an alternative, the complete abolition of limited liability has been proposed (Rothbard, 1973/1978) or its replacement in cases for tort claimants by a system of pro rata liability (Hansmann and Kraakman, 1991). While the complete abolition of limited liability may help involuntary creditors there are many arguments against it. First, the commercial benefits of limited liability should not be undermined. In particular, full removal would damage the protection currently afforded to voluntary creditors and would increase the risks of entrepreneurship. Voluntary creditors are in a better position than shareholders to monitor management and often have prior notice of the limits of a firm's capital, which can allow them to make an informed decision regarding whether or not to contract (see Hansmann and Kraakman, 2004, pp. 8–10). In addition, abolition of limited liability would end the advantages of voluntary creditors in cases of corporate insolvency. One compromise might be to remove the priority currently enjoyed by voluntary creditors, both secured and unsecured, over tort claimants in bankruptcy proceedings (Leebron, 1991). Nonetheless the complete removal of limited liability could see a return to the uncertainties as to which assets of the shareholders could be used to deal with the consequences of the bankruptcy. Furthermore, the complete abolition of limited liability would undermine the protection of entrepreneurs against personal ruin in the event of the failure of their business while at the same time failing to ensure the equality of all before the law, given that the more economically powerful could cope better with full liability than weaker market participants. It is not limited liability as such that is problematic but its unfair effect in giving immunity from liability for 'those in control of actions to further their own economic interests' (Plesch and Blankenburg, 2007, p. 38).

Second, the removal of limited liability will not do anything to prevent the misuse of control rights by shareholders in the company, who would continue to influence corporate decision making in their specific interests. The solution may not be the wholesale abolition of limited liability but in making it conditional upon the abandoning of such rights by the protected shareholder. The retention of full control rights would then be conditional upon unlimited liability on the part of the controlling shareholder (Ireland, 2008, p. 17). In the group context this makes sense as it recognises that the rights of the parent company to control subsidiaries creates responsibilities that are unfairly and unreasonably excluded by limited liability but which ought to be met. Indeed such a balancing of control rights and obligations of compensation for those adversely affected by their exercise is a feature of German law (Muchlinski, 2007, pp. 329–30). However, this extends only to the protection of minority shareholders in controlled undertakings. It does not affect liability towards involuntary creditors, which remains subject to traditional corporate separation and limited liability doctrines.

Third, the abolition of limited liability will not affect the vast majority of cases or remove the practical difficulties that remain in the recovery of compensation for tort claims. In particular, given that the most such claims do not exceed the assets of the subsidiary involved, and are settled out of court by the defendant's insurer, only a few 'mass tort' claims may require unlimited liability. But even in these cases very few claims are likely to be so large as to bankrupt the subsidiary. When such a risk arises there is every incentive to settle or to invoke insolvency proceedings, which do not favour involuntary creditors.

Furthermore, even if a judgment is obtained it may require complex international proceedings to be enforced (Cheffins, 1997, pp. 506–8).

Fourth, as regards jurisdictional issues, the abolition of limited liability by the jurisdiction in which the harm occurs would make that the applicable law to any tort claim brought by claimants from within that jurisdiction. This would require the extension of personal jurisdiction to the parent company on the basis of its exposure to liability. However, it is not clear that where the case is brought in the home jurisdiction of the parent the courts will be bound to recognise unlimited liability. They could hold that such a rule is contrary to public policy and refuse to recognise it.[9] Also, they could rely on the law of incorporation of the parent, the home country law, and say that it applies to determine whether the parent is a proper party to the case. In effect this was what the English Court of Appeal did in *Adams v Cape Industries* when the strict doctrine of corporate separation was invoked to deny the enforceability in the UK of the US court judgment in that case. Therefore, unless some measure of international consensus emerges as to the abolition of limited liability for multinational groups, jurisdictional defences are likely to remain where home countries seek to resist such changes.

Finally, as to pro rata liability this requires shareholders to compensate judgment creditors in proportion to their equity ownership in the company (Hansmann and Kraakman, 1991, p. 1892). In publicly held corporations such a rule could be used to cover, 'any excess tort damages that the firm's estate fails to satisfy' (Hansmann and Kraakman, 1991, p. 1896). Such a rule was in place in California from 1849 to 1931. Apparently the existence of this rule did not prevent rapid economic growth in that state during this period (Blumberg, 1986, pp. 597–99). However, a number of objections can be made against pro rata liability. In particular, in a group context a pro rata regime will not offer sufficient incentives for the controlling shareholder to internalise costs, as they can limit their liability by diluting their shareholding in the subsidiary while retaining control through a minority interest or by converting equity to debt. In addition, a pro rata regime will create greater litigation costs than a control based principle of parent liability, as all the possible shareholders who might bear a liability would have to be identified not just the controlling parent shareholder (Mendelson, 2002, pp. 1280–8).

5. Concluding remarks

This paper has sought to offer a critique of the limited liability and corporate separation doctrines in the context of claims made by tort victims against MNEs. It has shown how doctrines, created for a specific policy purpose in the nineteenth century, have had certain unacceptable consequences in such cases. On the other hand, this does not mean that existing Anglo-American law is toothless. It is possible to find a parent jointly liable with its subsidiary on general principles of tort law. However, this involves an often complex examination of the organisation of the MNE to prove that the parent was jointly responsible for the causes of the harm to the claimant and there are always the jurisdictional hurdles to cross. Such problems could be alleviated by a statutory rule that attributes liability (preferably strict liability, though negligence based liability would be an

[9] This was done by the New York Supreme Court, which refused to recognise the effect of the Argentine Supreme Court's judgment in the case of *Deltec Banking Corporation v Compania Italo-Argentina de Electricidad SA* (171 NYLJ 18 col 1, April 3 1974), where the latter had ruled that, in view of the 'unified socio-economic unity' of the Deltec group, the multinational group as a whole was jointly and severally liable for the debts of its Argentine subsidiary (Gordon, 1974).

improvement on the current state of no-liability) to the parent for negligent acts of the subsidiary on the basis of an enterprise liability principle coupled with a right to sue the parent in its country of domicile or in the country where the harm occurs based on the claimant's choice.[10] On the other hand, the complete abolition of limited liability is fraught with too many pitfalls to be viable.

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[10] Such is the current state of English law on jurisdiction following developments in European law (Muchlinski, 2007, pp. 158–9).

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