Briefing

Parent Company Liability for a Subsidiary's Operations:

Latest Judicial Guidance

McCann FitzGerald

INSTITUTE OF DIRECTORS IN IRELAND

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The English Supreme Court has yet again considered whether a holding company can be held liable for the actions of its subsidiary.[1] As in Ireland, the general position under English law is that the members of a limited liability company cannot be held responsible for that company's liabilities (known as the rule in *Salomon & Salomon*).[2] This protection may not apply in some circumstances however.

In law, the company is a legal person separate from its members, with its own property, debts and liabilities and the liability of each member is limited to the amount it has agreed to contribute in the event the company is wound up. Both recent English cases involved (unsuccessful) jurisdictional challenges to claims being brought in England and therefore did not decide the substantive issues of liability based upon the relevant facts; this will be done in future actions before the English courts.

Legal background

In England and Ireland, there are exceptions to the rule in *Salomon v Salomon* such that the "veil of incorporation" is disregarded at common law and by statute in certain limited circumstances and one company can have a liability for certain liabilities of the other. However, the cases under discussion are not ones concerning lifting of the veil of incorporation but concern wider tortious principles of the law of negligence.

1 *Vedanta Resources plc v Lungowe* [2019] UKSC 20 and *Okpabi v Royal Dutch Shell plc* [2021] UKSC 3
2 From the case *Salomon v Salomon and Co Ltd* [1897] AC 22

Case law in England had established that, in certain circumstances, a parent can assume liability directly to persons dealing with its subsidiary. The cases involved a parent having assumed a direct duty of care where it takes over the management of its subsidiary's activities or it gives advice to its subsidiary about how to manage a particular risk.

Irish courts have applied ordinary negligence principles to hold an owner of a company liable for injury caused to an employee of the company where the owner placed himself in a relationship of proximity to the employee (by engaging an untrained person to operate a potentially dangerous machine and issuing inadequate instructions as to how to use the machine).[3]

Judgement in Vedanta Resources

Duty of care

In *Vedanta* the Supreme Court of England said that it is possible for a parent to assume liability for the activities of its subsidiary, provided it assumes a duty of care to third parties in relation to those activities. As the case was concerned with a jurisdictional issue, it was not conclusive and a further decision is expected on the substantive issues. The decision did however make it clear that the Court disagreed with some decisions of the Court of Appeal that had held that a duty of care existed in only the very specific limited instances mentioned above. The Court in *Vedanta* held that parent liability under common law principles for actions of subsidiaries that causes damage to employees of the subsidiaries or third parties is not a novel basis of claim but comes within ordinary principles.

> *"A parent company will only be found to be subject to a duty of care in relation to an activity of its subsidiary if ordinary, general principles of the law of tort regarding the imposition of a duty of care on the part of the parent in favour of a claimant are satisfied in the particular case. The legal principles are the same as would apply 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."*

> *"Although the legal principles are the same, it may be that on the facts of a particular case a parent company, having greater scope to intervene in the affairs of its subsidiary than another third party might have, has taken action of a kind which is capable of meeting the relevant test for imposition of a duty of care in respect of the parent."*

3 *Shinkwin v Quin-Con Ltd and Quinlan* [2001] 1 IR 514

Group-wide policies

In *Vedanta*, counsel argued that the previous cases laid down a general principle that a parent could never incur a duty of care in respect of the activities of a particular subsidiary merely by laying down group-wide policies and guidelines, and expecting the management of each subsidiary to comply with them. The Supreme Court was not persuaded by this argument:

> *"…. not persuaded that there is any such reliable limiting principle. Group guidelines about minimising the environmental impact of inherently dangerous activities, such as mining, may be shown to contain systemic errors which, when implemented as of course by a particular subsidiary, then cause harm to third parties."*
>
> and
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> *"Even where group-wide policies do not of themselves give rise to such a duty of care to third parties, they may do so if the parent does not merely proclaim them, but takes active steps, by training, supervision and enforcement, to see that they are implemented by relevant subsidiaries. Similarly, it seems to me that the parent may incur the relevant responsibility to third parties if, in published materials, it holds itself out as exercising that degree of supervision and control of its subsidiaries, even if it does not in fact do so. In such circumstances its very omission may constitute the abdication of a responsibility which it has publicly undertaken"*

Role of parent in affairs of subsidiary

The Court made the following observations:

- Whether a parent assumes a duty of care in relation to its subsidiary's operations depends on the extent to which it participates in the management of some or all of the subsidiary's operations.
- A parent does not need to "control" a subsidiary to participate in its management. Control and management are different things. A subsidiary can maintain legal control over its activities, but nonetheless delegate management of them to "emissaries of its parent".
- A parent may incur liability to third parties if it holds itself out as exercising supervision and control of its subsidiaries, even if it does not in fact do so.
- Laying down group-wide policies or standards without actively enforcing them can create a duty of care. As mentioned above group guidelines may contain systemic errors which (when implemented by a subsidiary) cause harm to third parties.
- Where a group of companies establishes vertical reporting and business lines that operate across entities and distinctly from the corporate status of the various group companies, this could be an indication of control or participation in management.

- A parent is more likely to be exerting operational control where it imposes internal corporate policies and procedures on its subsidiaries. In *Vedanta*, the subsidiary sent compliance confirmations, health and safety audits and remediation plans produced to the parent so it could supervise how its policies were implemented.

Breach of duty of care

It ought be remembered that the potential existence of a duty of care is not the end of the matter. Even if a duty of care exists, no finding of negligence will be made unless it can also be shown that the parent breached that duty, causing harm to a claimant. The parent may be able to establish that it discharged its duty of care to the required standard and therefore has no liability to the third party. Any litigation however will involve costs (which might not all be recoverable by a successful party) and significant management time.

Helpful considerations

Whilst it is hoped that the expected future decisions of the English and Irish courts[4] will add further clarity to this important issue, there are a number of matters that commercial groups of companies (including those with subsidiaries in multiple jurisdictions) ought bear in mind:

- A parent can (and inevitably will have to) promulgate policies, including health and safety, risk and environmental policies, to its entire group. However, a parent should be careful not to administer those policies on behalf of its subsidiaries.
- A parent should ensure that group-wide policies do not contain errors.
- Although it is usual that decisions on a group's strategy and direction are taken by the parent's board or a group-wide executive committee, it is safer for matters concerning a particular subsidiary to be dealt with independently by the subsidiary's board.
- A parent should make it clear that it is not supervising or managing its subsidiaries' affairs. The subsidiary ought run its affairs as independently as possible, holding its own board meetings, for example, and using its own notepaper when dealing with customers and third parties.
- A parent should be cautious if it is advising a subsidiary on risk matters. If the parent possesses experience that the subsidiary lacks, it is likely that parent will offer assistance. Groups should give careful consideration to obtaining external advice from third-party risk consultants as a way to mitigate potential parent company liability.

4 The decisions will not be binding on the Irish courts but will be of persuasive value.

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