# Advancing Transnational Corporations' Overseas Environmental Accountability: The Impact of Mandatory Non-Financial Reporting on Foreign Direct Liability Claims before European National Courts

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**ABSTRACT**
This paper addresses the extraterritorial dimension of transnational corporations, focusing on the corporate accountability-deficit that characterizes the current International legal framework. The analysis looks at parent companies' civil liability for environmental harm caused abroad. By introducing a selected number of foreign direct liability cases brought before European national courts, the paper investigates whether the binding environmental and human rights reporting obligations contained in Directive 2014/95/EU contribute to the determination of a parent company's duty of care towards its overseas subsidiaries, and consequently establish their potential liability.

**Keywords**
Environmental harm; foreign direct liability; non-financial reporting; duty of care; parent company; directive 2014/95/EU

## INTRODUCTION

Economic globalization resulted in, and is itself the result of growing cross-border trade in goods and services, wide technological spread, deregulation of the market and, most importantly for the purposes of this paper, increasing cross-border production and division of labor within enterprises in different countries (Shangquan, 2000). Business entities have been adapting their structure, as well as their production methods as a way to increase profits and reduce production costs to the minimum (Enneking, 2012), even at the detriment of environmental and human rights protection. As a result, transnational corporations (TNCs) have become some of the most prominent players in the current social, political and economic arena.

TNCs normally conduct their business activities through foreign direct investments (FDIs), which entail the existence of a long-term relationship between an enterprise and another enterprise resident in a different economy, along with different degrees of influence at the management level (OECD, 2001). Oftentimes the parent company of a TNC is located in a developed country (for instance the US or a European country), while its subsidiaries are located in a developing country, where factors of production are cheaper and regulatory standards related to environment, health and safety and human rights are often less rigorous.

Against this setting, where economic entities have the ability to conduct their businesses transnationally and affect communities and environment beyond their home state's borders, the current International legal framework still lags behind in addressing its adverse consequences. As a result, TNCs' environmental and human rights accountability remains highly dependent on each state's ability and willingness to deal with the issue (Mason, 2005). This becomes particularly problematic when developing host countries may be incentivized to lower their regulatory standards in order to attract foreign investments (Enneking, 2012). For this reason, attempts have been advanced, at the national level, to bring civil liability claims (mainly cases of negligence) against TNCs in their home countries. The plaintiffs of these so-called *foreign direct liability* claims strive to recognize the extraterritorial accountability of parent companies, which are "the entities with the ultimate control over and profits from their international operations" (Enneking, 2012).

This paper advances arguments on the furtherance of European parent companies' accountability through mandatory CSR reporting, taking as an example the obligation to disclose non-financial information under Directive 2014/95/EU. The latter has the objective of increasing the level of transparency of the activities of corporations, in relation to environmental, labor and social matters, in order to create more sustainable business models. At the time of writing, no judicial or statutory interpretation was identified concerning the actual impact of the reporting obligation on foreign direct liability claims before European national courts. The reader should therefore be aware that the arguments advanced are based on consideration on what the law should be (*de lege ferenda*), rather than what the law currently is (*de lege lata*). Nonetheless, a number of national judgments, statutes and soft law instruments will be considered, in order to support the argument that the non-financial reporting obligation of Directive 2014/95/EU implies a parent company's duty of care, for the purposes of foreign direct liability cases brought before European national courts.

## FOREIGN DIRECT LIABILITY AS A WAY TO ADDRESS TNCS' OVERSEAS HARM

Direct liability claims brought against TNCs' parent companies in their home countries constitute a way to hold the latter accountable for environmental harm caused in the host countries. Many have argued that the role of civil liability (tort law) actions in this context is, however, rather limited, for a number of reasons: it is a very time consuming and expensive practice, primarily concerned with individual interests rather than common ones (such as environmental protection), and claims can be brought against the wrongdoer solely by a plaintiff with an interest at stake (Wilde, 2013). This is particularly problematic in cases of environmental damage, which cannot be judged unless an individual's interest or property is affected, as a result. However, in the absence of an effective International corporate liability regime, national civil liability systems remain, although not the most desirable, among the few tools to address the global dimension of corporate actors.

At the European level, this type of claims is based on general principles of domestic tort law and normally concerns violations of TNCs' duties of care towards their subsidiaries' employees or the communities and environment of the host countries in which they operate. At present, European national courts have finally adjudicated a limited number of foreign direct liability cases, leading to very little guidance on the extent and determination of a parent company's duty of care for the acts of its subsidiaries (Muchlinski, Rouas, 2014).

## PARENT COMPANIES' DUTY OF CARE

TNCs' accountability for overseas environmental harm and human rights violations is highly dependent on their corporate structure. Often, the creation of complex forms of ownership and control over subsidiaries all over the world reduces parent companies' exposure to liability. Many TNCs are organized in corporate groups, defined by Blumberg as "enterprises organized in the form of a dominant parent company with scores or hundreds of subservient sub-holding, subsidiary, and affiliated companies", which form a single-integrated enterprise under the control of one common entity (Blumberg, 2005). Each corporate entity has its own separate legal personality and the liability of shareholders is completely separated from that of the company's. The issue of holding a parent company responsible for the acts of its subsidiaries must adapt to these circumstances. Accordingly, parent companies can be either held indirectly liable for their subsidiaries activities, through the invocation of the veil-piercing doctrine, or directly liable for their acts or omissions (Demeyere, 2015). This paper addresses this second form of corporate liability, focusing on violations of legal responsibilities towards overseas communities and environment.

### The British courts' approach to determine the existence of a parental duty of care

Due to a number of procedural reasons, the foreign direct liability cases so far adjudicated before European national courts have failed to effectively recognize parent companies' duty of care for the harm caused during their overseas activities. What is certain is that the plaintiffs of such civil actions generally claim that the parent company of a foreign subsidiary breached a duty of care and that the failure to exercise due diligence eventually resulted in some form of damage to the local community and environment. For instance, in *Lubbe v. Cape clp*, the claimant alleged that the parent company (Cape clp) was aware that exposure to asbestos was gravely injurious to human health and failed to take proper steps to ensure that proper working practices were followed and that safety precautions were observed throughout the whole group, including its foreign subsidiaries in South Africa. In a series of foreign direct liability claims brought against Royal Dutch Shell plc (RDS) in the Netherlands, when addressing the issue of Shell's parental duties towards the injured Nigerian community, the Court of Appeal made reference to a British case, namely *Chandler v. Cape plc*, in which the judge formulated criteria useful to determine a parent company's duty of care in national tort actions. Although the Dutch court's final pronouncement on the application of this or other tests is still awaiting, and keeping in mind that an English court's pronouncement is nowhere binding upon Dutch or other European national courts, it is worth analyzing the Chandler criteria, which remain the most recent and relied on developments regarding the determination of parental duty of care in direct liability claims against TNCs.

#### *The Applicable Criteria*

In principle, according to the Chandler's judgment, a parent company's duty of care arises when the businesses of the parent company and its subsidiary are in a relevant part the same, and when the parent company is a position of knowing, or should have known that the subsidiary's activities were harming people and environment. In order to assess this last criterion, the court should look at the relationship of the two entities in a broad perspective, investigating whether the parent company had a practice of intervening in the trading operations of the subsidiary, concerning, for instance, funding or production issues (*Chandler v. Cape plc)*. Thus, a duty of care arises when the parent company is in a position of knowing or should know about its subsidiary's harmful behavior. In the case, a direct relationship between the parent company and the subsidiary's employees seemed not to be an essential element to establish a duty of care; rather, the matter revolved around the failure of the parent company to advise the subsidiary, when the latter was found in breach of its own duty of care towards its employees (Palombo, 2015).

It must be noted that the Chandler case was set in a national context, where both corporate entities (namely Cape plc and Cape Building Products Ltd.) were located in the United Kingdom. Thus, the test developed therein, and used to establish the existence of the parent company's duty of care, does not specifically refer to foreign direct liability cases. However, considering the interpretation of "proximity" delivered by the Appellate Court in the case, which deals with the parent company's knowledge or assumption of knowledge about the subsidiary's harmful behavior rather than a geographical proximity between the two entities, it can be reasonably assumed that the test would be applicable extraterritorially (Palombo, 2015), and thus be relevant for the purposes of this paper. This position seems to be confirmed in two foreign direct liability cases recently brought in the UK, namely *AAA and Ors v. Unilever Plc* and *Lungowe and Others v. Vedanta Resources Plc*, where the British High Court of Justice, in its preliminary rulings, addressed the Chandler test when assessing the feasibility of the claims against the two parent companies.

## THE IMPACT OF NON-FINANCIAL REPORTING OBLIGATIONS ON THE DETERMINATION OF A DUTY OF CARE

Thereby, in order to determine a parent company's duty of care, which is a necessary element to establish the latter's civil liability, the attention is drawn on investigating the factual existence of a practice of intervening in the trading operations of the subsidiary. This inevitably remains highly dependent on the specific facts of each of the cases. The absence of a clear definition of what constitutes a relevant "practice of intervening" in the trading operations of the subsidiary risks limiting the determination of such duty of care in a coherent manner.

This problem would be in part overcome, as it is argued in this paper, were the courts to base their assessment on the existence of a binding obligation upon parent companies to acquire information about their whole activities' environmental impact. By doing so, a company's failure to recognize the adverse impacts of its subsidiaries' operations would no longer be assessed as a question of fact, where the court would merely assess whether the company was in a position of knowing about its subsidiary's harmful behavior, through investigating the parent company's practice of intervening in the trading operations of its subsidiaries. Rather, the breach of a binding obligation to exercise human rights and environmental due diligence would be considered as a question of law, upon which it would be possible to attach legal consequences for the parent company.

### The Non-Financial Reporting Directive

In September 2014, the Council of the EU adopted Directive 2014/95/EU on disclosure of non-financial information by certain large companies. It is regarded as a considerable step forward, towards the creation of a more comprehensive and holistic CSR mandatory framework at the EU level. Public-interest entities, including public interest entities that are parent undertakings of a corporate group, with more than 500 employees registered in their balance sheet, are now required to produce a non-financial statement containing a brief description of the undertaking's business model, a description of the policies pursued to tackle, *inter alia,* environmental matters, including information about the due diligence processes implemented, the outcome of those policies, the risks related to the company's operations and the ways the company manages such risks. All EU MSs were required to transpose Directive 2014/95/EU into their national legal systems by 6 December 2016. According to the EU Commission, the new reporting rules would apply to around 6000 companies and corporate groups across the EU (EU Commission, 2014).

### Non-Financial Reporting as an Option?

Pursuant to Directive 2014/95/EU, the parent company of a large group of undertakings, which encompasses a parent company and its subsidiaries, must create a consolidated non-financial statement, including all the information necessary to understand the impact of the entire group's operations on people and environment.

Considering the recent interpretation delivered by the Court of Appeal in *Chandler v. Cape*, the determination of a parent company's duty of care concerns, *inter alia*, the latter's knowledge or assumption of knowledge about its subsidiary's harmful behavior. Even at first sight, the connection between this assumption of knowledge and a parent company's obligation to perform environmental and human rights due diligence seems apparent. As a matter of fact, by obtaining information concerning environmental matters, health and safety, greenhouse gas emissions, air pollution, as well as the specific risks related to the business operations, a parent company's knowledge about potential harmful behaviors throughout its whole corporate group is readily assumed.

Notably, the determination of a parent company's duty of care, based on the existence of a CSR commitment, is not unprecedented. In a 2008 French civil liability case concerning marine oil pollution, the Supreme Court ruled that the oil giant Total was directly liable for an oil spill that occurred on the high sea, due to the poor vetting operations performed on the tanker *Erika*. Total was the parent company of a whole corporate group, including *Erika*'s charterer, and had adopted an internal and voluntary vetting procedure to determine the tankers' suitability to transport crude oil and other hazardous substances. It was held that Total, by ignoring the bad state of maintenance of the *Erika,* had acted recklessly and with knowledge that an accident could have occurred (Gahlen, 2014). The court thus recognized the parent company's duty of care based on its voluntary commitment to carry out vetting operations on the charterer (Gregor and Ellis, 2016). Accordingly, Directive 2014/95/EU's obligation to report on non-financial information, which should include data on the due diligence procedures employed throughout the whole corporate group, may prove the existence of a parental duty of care. The failure to recognize the adverse impacts of its subsidiaries' operations, through the fulfillment of appropriate due diligence undertakings, would ultimately result in the parent company's direct liability for the damage caused.

In the Dutch Shell Cases, the court of first instance delivered a seemingly adverse interpretation of the matter. It asserted that the fact that RDS had a policy in place, aimed at preventing environmental damage caused by its subsidiary's operations abroad, was not sufficient to determine that the Dutch company had a duty of care towards the Nigerian community affected by the oil spill. However, there are a few elements of the decision that characterize the Dutch Shell Cases as one of a kind. To begin with, it is unclear whether the environmental damage was caused by sabotage, rather than by the Nigerian subsidiary's harmful behavior. Inasmuch as Nigerian law does not recognize companies' liability when pipelines are subject to sabotage, it cannot be excluded that the court would have reached a different outcome, had the damage been caused by the subsidiary's direct action or omission. Furthermore, RDS' environmental policy was not part of any mandatory obligation to report on non-financial information, and possibly lacked specific due diligence requirements, necessary to establish an assumption of knowledge. Arguably, the obligation set out in Directive 2014/95/EU, requiring the company to report on the outcome of its environmental policies, the risks related to its operations (including, for instance, the risks of sabotage) and the ways it managed such risks, would have facilitated the establishment of RDS' duty of care and, in turn, a breach of such duty.

## CONCLUSION

The determination of a parent company's duty of care based on Directive 2014/95/EU's non-financial reporting obligation has the potential of facilitating the work of European national civil courts dealing with foreign direct liability cases. Considering the Chandler test, which is commonly used to establish parent companies' duty of care by British and non-British courts, judges must prove that the parent company is in a position of knowing about its subsidiaries' harmful behavior. According to the British court, such knowledge ought to be assessed on the basis of a factual analysis, which would prove the parent company's practice of intervening in the subsidiary's trading operations. As argued in this paper, the parent company's knowledge about its subsidiaries harmful behavior would be readily assumed by merely considering the existence of a binding obligation to report on the risks related to the business activities, pursuant to Directive 2014/95/EU. Although the EU instrument does not specifically require companies to perform due diligence, but rather to report on such practice, the courts could base their determination on the existence of a binding obligation upon the company to know about any potential risks related to its operations. Whether the parent company fails to communicate specific risks is not relevant for the establishment of a breach of duty of care; the determination is rather based on its obligation to know about any potential risk, regardless of whether the latter was present in the non-financial statement. Based on this reasoning, national courts would no longer have to assess whether the parent company had a practice of intervening in its subsidiary's trading operations as a way to prove knowledge, but rather the mere existence of an obligation to report on information, as to the risks encountered throughout the activities, constitutes the necessary evidence of knowledge or assumption of knowledge needed to prove the existence of a duty of care.

A final court ruling on the matter is still awaiting; however some recent legal developments seem to support the argument proposed. A very significant step forward in the debate was signaled by the adoption of the so-called "corporate duty of vigilance law" by the French Parliament, in February this year. Around a hundred French companies failing to report on their activities' adverse impacts on people and environment, would now be liable to compensate for the harm that due diligence would have otherwise prevented (ECCJ, 2017). It is plausible, or at least desirable, that other European national courts will embrace a similar approach, when faced with the issue of establishing a parent company's duty of care, based on Directive 2014/95/EU's non-financial reporting and due diligence obligations, or other alike instruments.

## ROLE OF THE STUDENT

Silvia Barlassina was an undergraduate student working under the supervision of Dr. Agnieszka Machnicka when the research in this report was performed. The topic was proposed and entirely developed by the student. The writing was completed by the student, under the supervision of her supervisor, during the academic year 2016/2017.

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