Liability of Multinational Enterprises for Their Subsidiaries' Torts
Eroglu, Muzaffer

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“Liability of Multinational Enterprises for Their Subsidiaries’ Torts”

By

Muzaffer EROGLU

A thesis submitted for the Degree of Doctor of Philosophy
Queen Mary College, University of London

May, 2007
I declare that this work is my own.

Muzaffer EROGLU

01 May 2007
The purpose of the thesis is to examine problems related to the liability of multinational enterprises (MNEs) for their subsidiaries' torts. The reason for the existence of the problems is that the legal theories and practice fail to understand interdisciplinary features of MNEs. Thus, there have been no satisfactory solutions to the problem of tort liability of MNEs.

In order to understand the questions of liability, there should be an examination of the concept of multinational enterprise using interdisciplinary methodology. Thus, the thesis, in the first section, examines the social, economic, managerial and legal characteristics of MNEs and compares the findings of this examination to the current understanding of MNEs in the way that tort liability is applied to them. As a result, there is a conflict between legal understanding of the structure of MNEs and contemporary realities; while legal practice considers MNEs as simple vertically structured organisations; an interdisciplinary examination reveals more complex horizontal structures with different characteristics. This conflict creates problems of liability and also prevents satisfactory solutions to problems of tort liability in the context of MNEs.

In the second section, the thesis examines the existing laws related to liability of MNEs from different jurisdictions. The aim of this examination is to assess whether these laws are adequate for the challenges modern MNEs create. The thesis seeks in each sub-section to understand how groups of companies are conceived by these laws and how liability rules would be different if modern understandings of MNEs are applied in these cases.

In the final section, the thesis aims to identify the basic problems of achieving satisfactory tort liability for MNEs and it offers solutions to the problems of liability for MNEs subsidiaries' tort based on the findings in the first and the second parts of the thesis.
I was very lucky to have had the chance to work with Professor Janet Dine during my PhD. As a PhD supervisor she was excellent, and approached to the issues in such a kind and constructive way. I have also been grateful for the full financial support provided by the Ministry of Education of Turkey.
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Daimler v. Continental Tyre Co [1916] 2 AC 217
DHN Food Distribution Ltd. v. London Borough of Tower Hamlets [1976] 1 WLR 852
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Australia

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India

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Germany

Autokran BGHZ 95, 330
ITT BGHZ 1976 JZ 561
TBB Zeitschrift fur Wirtschaftsrecht (1993) 589
Tiefbau GBHZ 107, 7
Video BGHZ 115, 187; Die AG. 1991, 429

France


Others

ICC Interim Award of September 23, 1982 in No.4131. 1984 Rev. Arb. 98
ICC matter no 5103 1988 Journal du Droit international 1206
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<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AATUHK</td>
<td>Amme Alacaklarının Tahsili Usulu Hakkinda Kanun</td>
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<td>ATCA</td>
<td>Alien Tort Claims Act</td>
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<td>BITs</td>
<td>Bilateral Investment Treaties</td>
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<td>CA</td>
<td>Companies Act</td>
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<td>CERCLA</td>
<td>Comprehensive Environmental Response, Compensation and Liability Act</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>DFID</td>
<td>Department for International Development</td>
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<td>DTI</td>
<td>Department of Trade and Industry</td>
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<td>EC</td>
<td>European Commission</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
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<td>EFTA</td>
<td>European Free Trade Association</td>
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<td>EPZ</td>
<td>Export Processing Zones</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IA</td>
<td>Insolvency Act</td>
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<td>ICC</td>
<td>International Chamber of Commerce</td>
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<td>ICSID</td>
<td>International Centre for the Settlement of Investment Disputes</td>
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<td>ILO</td>
<td>International Labour Organisation</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>M-form</td>
<td>Multi-Divisional Form</td>
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<td>MNE</td>
<td>Multinational Enterprises</td>
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<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
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<td>NGO</td>
<td>Non Governmental Organisation</td>
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<td>OECD</td>
<td>Organisation for Co-Operation and Development</td>
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<td>U-form</td>
<td>Unitary Form</td>
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<td>Acronym</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Developments</td>
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<td>WIR</td>
<td>World Investment Report</td>
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<td>WTO</td>
<td>World Trade Organisation</td>
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LIST OF STATUTES, OTHER STATUTORY AND INTERNATIONAL INSTRUMENTS

The UK

Companies Act 1985
Companies Act 2006
DTI, Company Law Reform Bill, the White Paper (CM 6456. March 2005)
Employment Rights Act 1996
English Companies Act 1862
Insolvency Act 1986
Joint Stock Companies Act 1856
Limited Liability Act 1855
Limited Liability Partnership Act 2000
The Civil Jurisdiction and Judgement Act 1982

The USA

Alien Tort Claims Act, 1789. 28 USC § 1350
Judiciary and Judicial Procedure Act, 1948. 28 U.S.C. § 1404(A)
Sherman Antitrust Act. 1890. 15 USC § 1
European Union

Communication from the Commission to the Council and the European Parliament
'Modernising Company Law and Enhancing Corporate Governance in the European Union- A plan to Move Forward' (COM (2003) 284 final)


EC EFTA Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (Lugana, 16 September 1988)

European Company Act (SE); Commission for a Council Regulation on the Statute for a European Company, (COM (89) 268 final- SYN 218)


Turkey

Law Regarding with the Procedure of Collection of Money Owed to the State, 1953

Turkish Civil Code, 2001

Turkish Commercial Code, 1956
Germany

German Stock Corporation Act, 1965

Others


OECD Guidelines for Multinational Enterprise (2000)


CHAPTER I: INTRODUCTION

The thesis aims to examine the liability of multinational enterprises (MNEs) for their subsidiaries' torts. Although the discussion of liability has increased in recent decades, the laws that apply to MNEs liability cases are not developed enough to offer a satisfactory solution to MNEs' tort problems. The reason for the failure to find a solution to the tort liability problems can be found in the lack of understanding of the concept of MNEs in interdisciplinary studies. Accordingly, the statement of the thesis is that there is a conflict between the understandings of basic features of MNEs in legal studies and the realities of the modern concept of MNEs. Thus, the thesis aims to provide interdisciplinary examination of MNEs and test the existing liability rules to see whether they are adequate to solve the problems and as a result it aims to offer solutions to the liability problems in the context of MNEs.

The recent movement in world trade is opening up domestic markets for investors from other countries. States are liberalising their markets by offering generous and specific investment incentives designed to attract investors since international economic theory claims that overseas investment is good for MNEs for a number of profit-creating benefits while it is good for host countries since the capital and technology brought by MNEs is crucial for the economic development of countries and regions. Accordingly, there has been a progression to a more international economic world order, creating the concept of globalisation.

Economic globalisation- the linked process of trade and investment liberalisation, privatisation and deregulation- developed on the idea of open markets has brought huge increases in movements of capital, goods and services. Multinational enterprises are the vehicles for much of this globalised economic activity, and in turn, foreign direct investment by MNEs accounts for an increasing proportion of global economic activity.

At a global level, the world economy was in constant growth in the 19th and 20th centuries. There were a number of factors and actors for this growth process. One of the
main factors for international economic growth was the efficiency of considering companies as centres for capital creation. This practical utilization of companies was one of the important factors for the emergence and survival of economic capitalism.

In the early stages, the clever use of companies as a capital creating tool was very efficient at the domestic level. Companies at a domestic level transform themselves first into corporate groups with help of rules allowing a trouble-free approach to the emergence of corporate groups. Corporate groups accumulated huge domestic savings with the ability to use it wherever possible and whenever profitable. Thus, once the groups are big enough, they consider investing in foreign markets. While doing this they use every power they have accumulated in order to create more beneficial business environments for themselves. The key factor in determination of the relative efficiency of foreign incorporation derives from many internal and external factors. The most important reason for foreign direct investment (FDI) is the ever-growing market pressure to increase their profits.

Since the first emergence of companies with modern company laws in the middle of the 19th century, there has been constant transformation of MNEs’ investment strategies and organisational structure. An interesting point in this process was that neither political, nor legal developments have been able to match this dynamic self-transformation in corporate groups’ structure. Accordingly, MNEs have acquired unique legal and political status in the world.

Presently, despite the arguments, it is true that MNEs are one of the biggest actors in both developing and developed economies. In some situations, MNEs can even be in conflict with states, the most advanced social institution created by mankind. This modern image of the corporations has been developed since the time companies first emerged. Hobbes, who found the rise of corporations threatening to the state’s authority, noted “the great number of corporations; which are as it were many lesser
commonwealths in the bowels of a greater, like worms in the entrails of a man". The difference between that time and today is the greater internationalisation of corporate activities and thus the emergence of bigger and more powerful corporate groups. Accordingly, MNEs are a phenomenon of contemporary societies that have a great magnitude and raise some specific economic, financial, and legal, social and human rights problems. Their transnational character, their economic and legal versatility, their enormous economic and financial power and their great political and social influence are important obstacles to any attempt to exert on them legal and social control.

The power of MNEs is not completely self-built since international policy making works to the benefit of MNEs in many senses; international organisations are helping companies to operate on a large scale; the devotion to open market economies in international economic policy-making is expanding territories with open market economies in the world. Thus, the current domestic and international policies of developed economies depend on supporting more corporate activities through any means at domestic or international levels. The fierce support of privatisations and market liberalisation by the International Monetary Fund (IMF) and World Bank are important in the expansion process of MNEs activities. Moreover, the World Trade Organisation (WTO), with ever-growing members, is changing the dimensions of international dispute settlement in trade matters, which gives MNEs more power to circumvent national court systems. Furthermore, there has been an enormous increase in bilateral investment treaties (BITs) in the last two decades between developed countries and developing countries. The BITs grant power to MNEs to challenge host states according to dispute settlement provisions that mostly require international arbitration. Moreover, MNEs have been given permission to use international dispute settlement tribunals such as the International Centre for the Settlement of Investment Disputes (ICSID).


Regional and international trade agreements are designed to reduce the level of conflict related to MNEs' activities to a minimum. In many cases, human rights, environment and even public health are considered as obstacles to international trade since any conflicts under these concerns are considered a deterrent to MNEs. Thus, this immense power of MNEs, the aid of some of the major world powers and the complicity of many governments, have made it possible for them to intertwine a basic network of norms that are contrary to national and international public law in force, in the shape of BITs for the protection of foreign investments and regional agreements such as North American Free Trade Agreement (NAFTA).³

The complex appearance of MNEs in the world economy provoked a good deal of criticism. MNEs are accused of causing serious harm to the people of the world and exploiting national economies and societies and even undermining democracy. In reaction to these problems, many people and countries demanded abandonment of MNEs' activities in their territories. However, on the other hand, most of the less developed countries try to attract those companies to invest in their countries because MNEs are considered a basic source of technology, employment, and capital and thus as main actors in economic development for their countries. This creates a dilemma, on the one hand, countries want to attract more FDIs by giving economic and legal incentives but on the other hand, they have to protect their citizens against any breach of law and torts committed by MNEs.

It is not easy to attract MNEs to any territory; successful FDI attraction needs a very favourable scheme of economic and legal incentives. Sometimes, exemption from liability for the breach of some basic human rights could be possible. In many countries, governments bend or remove their own labour and environmental legislation to allow MNEs a freer hand, or turn a blind eye to violations. States, such as Sri Lanka, have created export processing zones (EPZ), within which the state allows a separate system of law or waivers of national law. At worst, MNEs and governments actively collude to

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³ UN, Economic and Social Council, 'Adverse Effects Of The Illicit Movement And Dumping Of Toxic And Dangerous Products And Wastes On The Enjoyment Of Human Rights' (E/CN.4/2001/55, 19
operate profitable national sources; MNEs ignore abuses made by states in order to create better operating conditions, or even worse they demand any protest or civil activity be stopped at any cost. In many cases, MNEs prefer less-developed countries as a primary place of investments to escape strict safety, labour and environmental regulations in developed countries. For example, San Diego based Sempra Energy decided to build its new natural gas-fired power plant just over the border in Mexico in order to avoid stringent air quality regulations in southern California and escape from completing detailed environmental impact statements. As a result, MNEs have acquired strong economic power and they are one of the centres of policy making in the world. The effects of MNEs are felt at every level of society from the bottom to the top, which makes examination of MNEs as international economic, social and legal institution a necessity.

In a legal examination one will see that, while all these developments are taking place in the world, the general principles of company law have not changed since its first emergence. Companies were considered basic institutional forms to convince people to invest and to create a cumulative capital to make the necessary investment required for large-scale economic activities. For this reason, shareholders were granted immunity of liability to convince them to invest their capital. This immunity later was also given to corporate shareholders, which altered the area of corporate law fundamentally and irrevocably.

Thus, the broad ranges of economic incentives given by countries are actually just the surface part of a huge iceberg. The real incentives lie under the structure of law of developed countries, which are copied by many developing and less developed countries since MNEs and governments in developed countries as well as international financial organisations first demand a modern company law in a country eager to attract FDI. It is interesting for example in even such small and politically conflicted countries or territories, such as Kosovo, there is a push to legislate modern company laws, even

January 2001)
though these communities have virtually no international trade yet. Moreover, big economic powers, such as China and Russia, had to change their company laws to western style company laws to attract more investments in their territory. There is also ongoing effort in Turkey to change company law, which is already western, to make it more modern and up-to-date.

In contrast to slow developments in the legal area, in the area of MNE in economics and management, there have been huge dynamics inside MNEs to change their own structures. While economic activity in the 19th century was growing at domestic and international levels there was a need for better-organised institutions. This gap was filled by allowing corporations to have shares in other corporations. The result was emergence of corporate groups in domestic business while multinational enterprises took their place in the international business world. Accordingly, the organisation grew gradually while changing its structure over time to adopt better and more competitive business environments. In some organisations, it went beyond borders, creating its own studies in economic and managerial fields; there have been many attempts to understand basic operative and managerial structures of the MNEs.

This complex structure gives grounds for more sophisticated problems in the area of MNEs, which is still mostly regulated by the rigid principles of company law settled in the 19th century. Thus, there is always a claim that MNEs are primarily governed by the national legislation of the countries in which they operate. However national legislations in developing countries are weak or they do not have the political will or technical know-how to enforce liability. Moreover, increasingly, corporations' headquarters are located in one country, where they are registered, with sourcing or production networks linking them to subsidiaries in another country or countries, while they have share listing on several stock exchanges. They can move money around and within the enterprise, relocate their headquarters and subsidiaries in response to changing legal and social environments, and play one government off against another to

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obtain more favourable tax and regulatory treatment. Under these conditions, being regulated by host states does not increase level of liability of MNEs but gives them power to manipulate the countries’ fragile legal systems.

The complicated structure of the international economy puts MNEs in positions of extraordinary power and equally extraordinary lack of accountability to anyone or anything except their shareholders. Accordingly, the directors can always legitimate their decisions by claiming they have a duty to produce the best for the shareholders. Under these conditions, the only aim would be to maximise profit whatever it costs to outsiders of the company.

While aiming at profit maximisations, MNEs are not reluctant to use any possible incentives offered to them or any gap in the law. Current structures of company law offer many gaps in this sense; the businesses might use shell companies in order to escape from liability. Moreover, at the international level, the corporation might divide up its assets to many locally operating subsidiaries while escaping overall group liability. Not surprisingly, these problems of company laws ability to regulate MNEs are not unknown at governmental and international organisations levels.

One particular problem MNEs create is of the utmost importance and thus will be examined in this thesis. With developments in the global economy and MNEs transformation, other global common characteristics of the international economy have emerged, the globalisation of corporate victims. In recent decades the world witnessed the global phenomenon of corporate torts. MNEs have been involved in mass tort actions in various parts of the world and mostly escaped justice easily. With the campaigns of non-governmental organisations (NGOs), the dark side of the global economic order has been revealed. It has become usual to witness a new example of corporate torts on a daily basis. These torts were more severe and common in less-developed countries. But, it is not surprising to see the same level of corporate tort in developed countries. Some incidents have attracted worldwide publicity while many

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5 UN, Economic and Social Council, (E/CN.4/2001/55) (n 3)
others were simply forgotten thanks to the difficulty in bringing a tort action against MNEs.

The cases for corporate torts vary from country to country according to their economic and social characteristics; in less developed countries there is usually collusion between the state and MNEs. In severe cases, MNEs are ignoring safety and environmental regulations causing many injuries and deaths. In developed countries, since the law is more developed, MNEs use the legal incentives given by company law statutes by dividing their entity into many sub-units to escape possible lawsuits.

Yet, despite this surge in interest in corporate tort responsibilities, there remain certain important countervailing factors. The most important among these is the disagreement between the objects and practice of globalisation of tort victims, and that of economic globalisation on the other. Certainly, international trade law essentially grants numerous rights to MNEs and very few enforceable duties, and few of any apparent significance in respect to tort victims.

What is interesting in this sense is the lack of action taken by states to create improvements in this situation. It is somehow understandable for less developed countries to ignore most of the allegations in order not to lose investments but developed countries also take no action. There is hardly any effort by parliaments to change the current situation and courts do not try hard enough to create better regulations. Instead, with the efforts of NGOs, the existing laws, such as Alien Tort Claims Act (ATCA), are usually stretched in an attempt to impose tort liability on MNEs.

Accordingly there are a number of obstacles that prevent justifiable solutions to MNEs' torts; attempts to find justifiable solutions to corporate tort often have resulted in disappointments for multiple reasons from current legal systems to negative campaigns run by MNEs. There is a political unwillingness in less developed countries not to scare MNEs. Moreover, there is collusion between MNEs and governments in less developed countries so states are not willing to enforce existing laws and often pass laws which actively exempt MNEs from their national legal systems, often under pressure from their own economic needs. In developing countries, the laws and models of the legal system,
originating from the developed countries, where the companies have their centres, are weighting the system towards the already powerful. Thus, both home and host countries legal systems are not efficient to solve the problems.

Therefore, MNEs escape from possible lawsuits with reverse forum-shopping, where the accused corporation fights to have a case refused in a country favourable to the complainants (usually the home country) and to get it returned to a location favourable to itself (usually the host country). This is a first strategy carried out by MNEs when faced with tort claims under home countries’ laws. They use a number of gaps in private international law to reverse back cases to their origin where they are likely to remain unsolved. The cases that have overcome forum problems will have to struggle with the corporate veil and disguised ambiguities in the nationality of MNEs and the separation of identities of the parent company and the subsidiaries, created by MNEs to enable them to escape legal responsibility in any country where they operate.

The forum problems together with substantial and theoretical problems in company laws are basics obstacles to preventing MNEs’ tort liability. There are a number of other factors that prevent liability; any small achievement at international level in creating better liability will be blocked by poor implementation mechanisms in most international regulatory instruments, if they are not already weakened by commitment to the voluntary regulations since internal codes of conduct allow corporations to claim to be good while not imposing any legal obligations on them, and so do not address the claims of MNEs’ victims. Moreover, the expenses of legal actions can sometimes be crippling even in the case of a victory, particularly, where a group of poor people, are defending themselves against a corporate counteroffensive.

Despite all these beneficial environments for MNEs to operate with only a small risk of liability, there are counteroffensives by MNEs. MNEs have been involved in an intense lobbying battle to change the existing law of torts that allow victims to be compensated. Moreover, the system of out of court settlement is giving rights to companies to avoid having an effective ruling on certain issues; in a number of recent
cases even though MNEs argue that they are not liable, they settled cases so that substantial grounds for future claims have been prevented.\(^6\)

These problems are not independent from each other and some of them are core law problems while some of them are related mostly to the political preference of countries. In this thesis the discussion will concentrate on the core-law issues; mainly jurisdictional problems and company law problems. Leaving aside more social-political arguments, the concentration in this thesis will be on the legal obstacles for creating MNEs' tort liability since the legal structure of corporate groups makes it possible for them to evade liability easily. Actually, this situation has been praised by many business and economic commentators for its success in raising capital through granting immunity from liability. This aspect was reflected in a newspaper report very dramatically. An American MNE, Halliburton, has settled asbestos claims for $5 billion. The interesting and important remark in this report is this part; "Halliburton has won praise on Wall Street for the way it dealt with an issue that could have led its demise. By separating the oil business from the other subsidiaries, it was able to protect itself from lawsuits and built up cash to pay a settlement."\(^7\)

Accordingly, MNEs' gift of spreading power, their capacity to be present in several parts of the world and nowhere at the same time, allows them to avoid national jurisdictions. The unique characteristic of MNEs' structures together with private international law and company law makes access to justice in MNEs' tort situation very problematic. The treatment of foreign subsidiaries of MNEs as independent legal persons separate from a sophisticatedly structured group, results in a situation that victims of these subsidiaries might bring their legal actions only against torts committed by a subsidiary in its own jurisdiction.

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\(^6\) Report is at [www.guardian.co.uk/burma](http://www.guardian.co.uk/burma), and the Guardian, 15 December 2004. Accordingly, there was out of court settlement between the energy MNC Unocal and Burmese villagers. The villager claimed the company's Yadana pipeline has led to deaths, rapes and the disruption of their lives. The amount of compensation is not disclosed. The lawsuit was launched in 1996; the action was brought to California using the ATCA. There were US governmental fears that, if the action succeeded, it could lead to a flood of similar claims by indigenous people whose lands had been used for pipelines or oil drilling carried out by multinationals.
Limited liability, which first emerged as a capital-raising tool in the simple form of a company, is now used as a liability evading tool for corporate groups. Thus, in a simple evaluation of limited liability, it will be seen that limited liability almost grants a company more rights than private property grants since private property owners are liable for the damage that is caused by the misuse of property. For example, where a house or car cause damage to people, there is full liability of owners for compensation but if a company causes the same injury and goes bankrupt because of the consequences, shareholders are liable for not more than they invested in the company.

While all these negative sides of corporate law and private international law were being misused by MNEs to escape from liability, responses by lawmakers to corporate groups challenge were at a minimum level and in very specific circumstances. Both actors of law making (courts and parliaments) have failed to give immediate and satisfactory responses to these unfair situations. Responses were mostly related to corporate groups' laws without a comprehensive examination of MNEs, thus they failed to create significant change in the current situation related to MNEs' tort liability.

Given the characteristics of MNEs, the expectations at international and national level of regulations are high but there have been different approaches to the issues. They prefer to create code of conducts or guidelines, which do not have clear enforcement mechanism. While at a regional level, the EU, even though it was expected to be creative, considered the issues in narrow sphere of company and group of companies' law. At a global level, ideally, an international legal framework or convention is needed to discuss the activities of MNEs and to help encourage legislation at national level, but none has been drafted.

Regulatory efforts have been concentrated on the issues mostly relevant to the practical operational environments of MNEs, rather than liability issues. Thus, most of the efforts related to groups of companies were in favour of MNEs activities or related to public law issues, such as tax law. Even in the European Union one of the first attempts

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7 *The Daily Telegraph*, (London, 05 January 2005)
in company law was to regulate consolidated companies accounts in the Union. When the issue is collecting money for governments, there are many regulations but if the issue comes to the compensation of poor people from the other jurisdictions, courts, parliaments and governments strictly refer to rules of limited liable company. It is very difficult to justify the fact that corporate groups are allowed to prepare consolidated accounts but in case of tort of one company in the group, creditors cannot claim compensation from the others.

However, it would be unfair to claim there have been no regulatory efforts for corporate tort liability; there have been some efforts, which tried either directly to hold corporate groups liable for their torts by a different model of laws to create some sort of liability regime in the corporate groups’ context. However, those efforts, either in statutory law or in case law, have been weak and inefficient.

The reason for this failure could be found under the conception of MNEs in a legal world under which corporate groups have been traditionally considered as having one central decision-making body. Accordingly, in a group situation when one of the companies in the group has fallen under the control of the parent, the regulators incline to make the controller liable for the torts of the controlled one. Therefore, the courts were never inventive beyond the theory of veil piercing, which has very strict conditions. Mostly, theories related to veil piercing, developed for small companies, tried to be applied in the corporate group context. Eventually, it was almost impossible to demonstrate and prove the strict requirements of veil piercing in corporate groups. Thus, the efforts to extend veil piercing theory to corporate groups have failed.

Interestingly, academic discussions in the area of corporate groups’ liability were somehow successful in pointing out the problems of the application of limited liability in corporate groups’ context and thus evasion of liability against involuntarily creditors. However, solutions suggested were mostly short and unconvincing due to misinterpretation of economic and managerial characteristics of MNEs. Thus, suggestions offered by academia have never been inventive enough to be considered as alternatives. The failure was due to lack of interdisciplinary examination in the area of MNEs activities and thus, misinterpretation of the way control by one entity over another in
MNEs was used. There has always been belief in the simple top to bottom control since they have never gone beyond the theory of firm to develop a theory of a multinational enterprise.

The structure of MNEs makes it almost impossible to establish a tort liability under the control theory in a group situation because the horizontal structure transformed the control theory in real terms into less-hierarchical but more complex decision making process. However, in law-making the concept of MNEs as a simple vertical structure has never changed. Thus, expectation from current regulations and efforts based on misconception of MNEs are very low and results have been logically unsatisfactory.

Accordingly, there is a requirement that MNEs must be examined from interdisciplinary perspectives in order to create better regimes of liability for MNEs’ tort; there must be extensive efforts to discover what the basic theories behind MNEs are. This examination should cover economic, social, organizational and legal areas. When applying these requirements into the current thesis, the future of MNEs tort liability must be discussed from two perspectives, first there must be an examination of basic economic managerial social and legal characteristics of MNEs and secondly the existing regulations must be tested to see if they are efficient enough to meet the challenges. As a result, suggestions on MNEs liability must be built on the results of extensive interdisciplinary and inter-jurisdictional methods.

Accordingly, the thesis aims to indicate the social, economic and organisational characteristics of MNEs. The purpose is to evaluate how different MNEs are conceived in other disciplines and how this perception of MNEs in legal discipline and practice has been absorbed. While doing this there will be indication of theories developed by legal practice in order to solve liability problems in groups of companies’ context. The concentration will be on the perception of MNEs structure in legal theory and the liability theories developed on this perception, namely the theory of control in MNEs management structure. The reason for concentration on the structure and the theory of control is that from the early discussion of the liability of groups of companies to the latest liability proposals, liability of MNEs, applied or suggested, have been based on the
simple and inefficient understandings of structure of MNEs and thus on the inefficiently developed control theory.

Therefore, liability applied or suggested was based on a simplified formula, which considered corporate groups as vertically organized institutions, thus the control theory was one-way control applied by parent companies over subsidiaries. Accordingly, there have been very long and strict requirements in order to establish liability; plaintiffs are required to prove the excessive control of parents over their subsidiaries. This requires very detailed fact specific inquiry and thus is almost impossible to prove in the modern structure of corporate groups. This misunderstanding has caused another negative result in that there have never been real discussions or applications of group liability; rather parent-subsidiary liability has been considered as the only possible ways of establishing liability in corporate groups' context.

In order to bring modern interdisciplinary understandings of MNEs together with legal disciplines and try to create modern proposals for MNEs' tort liability the thesis will be divided into six chapters and chapters will be divided into sections. The first chapter is the present chapter where the introductory arguments are made.

The second chapter of the thesis will be devoted to the examination of basic social, economic, managerial and legal characteristics of MNEs under the title of concept of MNE. The chapter will be divided into sections; the first section will be an examination of social and economic characteristics of MNEs; there will be a search for where MNEs stand in current social-economic orders and how they operate. There will be a historical look at the concept of MNEs starting from the first emergence. The process will be examined together with FDI movements and there will be a quest to discover the rationale behind the investment theory by simply asking why MNEs invest. This examination will contribute to the discussion of tort liability by pointing out the basic social-economic characteristics of MNEs; the aim is to indicate that different social-economic characteristics need different laws and regulations. The second section will be an examination of the organisational structures of MNEs under which there will be a close look at MNEs from the inside. The theory of corporate structures will be examined in an historical context and the basic features of managerial organisational structure of
MNEs will be examined and later concentration will be on contemporary corporate structures. While doing this, some examples of structures of modern MNEs will be demonstrated. This managerial organisational examination has key importance for two reasons: first, the complex structure of MNEs prevents any liability theories and laws to be applied in MNEs torts. Second, the future law and theories must be built by considering the current characteristics of the structure of MNEs. The third section of the chapter will be an examination of the legal theory behind MNEs’ regulations and liabilities. The examination will be historical; first the emergence of corporate groups and secondly an evaluation process of corporate personality and limited liability will be made. The difference between individual and corporate shareholders will be identified. The overall aim of the second chapter of the thesis is to indicate the basic feature of MNEs as unique institutions. Consequently, the weakness of legal theory and regulations applied to MNEs will be better understood and this interdisciplinary examination will indicate the basics theoretical problems in the area of MNEs tort liability.

In the third and fourth chapters of the thesis, there will be examination of how the modern structure of MNEs create obstacles to solving tort liability and solutions created by courts or parliaments or suggestions made by academics will be examined by asking if they match the demands to bring interdisciplinary approaches to MNEs tort liability discussions or not.

Accordingly, in the third chapter, jurisdictional problems of imposing MNEs’ liability will be examined. The importance of jurisdictional obstacles to imposing tort liability will be the beginning of the discussion. The so-called *forum non conveniens* theory and further obstacles will be examined by giving examples from English and American jurisdictions. Then, suggested solutions to the jurisdictional problems will be discussed. As in other parts of the thesis, the examination of jurisdictional problems and solution suggestions will be comparative and interdisciplinary by questioning how current laws meet the challenges.

In the fourth chapter existing laws on groups of companies and liability issues to MNEs will be under critical examination. The case law and statutory law will be examined separately. In case law, examination of piercing the corporate veil will be
central. Both case law and statutory laws examinations will be comparative: ranging from the UK laws to some examples from the US as well as approaches in the EU law will be discussed. Moreover, individual efforts from Germany and Turkey will be examined and further reference to laws from other jurisdictions will be made. The aim of this chapter is to discover the approaches of lawmakers to the problem of groups of companies and MNEs liability and compatibility of these examples with interdisciplinary features of MNEs.

In the fifth chapter the thesis will examine the findings in the previous chapters questioning those findings from two perspectives. First, there will be a quest to find out what are the obstacles to imposing better developed liability rules on MNEs. The second quest will be how and on which criteria the future of MNEs’ liability must be built. The suggested solutions will be based on results of examinations made in the previous chapters.

The sixth chapter will be the conclusion.
CHAPTER II: CONCEPT OF MULTINATIONAL ENTERPRISE

Introduction

A multinational enterprise can be defined as an enterprise that has affiliates in more than one country. On the other hand, the multinational enterprise, in a strictly legal sense, can be defined as a collection of corporate entities, each having its own juridical identity and national origin, but each in some way connected by a system of centralised management and control, normally exercised from the seat of primary ownership. This definition does not exist in any statute or in any official documents.

According to some researchers, multinational enterprises have existed since ancient times. They come to the conclusion, after researching ancient business history that MNEs were actively operating in the times of Roman, Greek, Mesopotamian and Anatolian civilizations. The first recorded MNEs appeared in the Old Assyrian Kingdom shortly after 2500 BC, when Sumerian merchants found in their foreign commerce that they needed men stationed abroad to receive, to store and to sell their goods. The researchers found that the MNEs of ancient times have some similar characteristics to contemporary MNEs. On the other hand, some other researchers find the forerunners of MNEs in medieval times in chartered trading colonizing enterprises. For example, the East India Company, chartered in London in 1600, established overseas branches. In the mid-seventeenth century, English, French and Dutch mercantile families sent relatives to America and to the West Indies to represent their firms. So too, in time, American

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colonists found in their own foreign trade that it was desirable to have correspondents, agents, and, on occasion, branch houses in important trading centres to warehouse and to sell American exports. These early-chartered companies can be regarded as closer predecessors of the modern MNEs.

However, for the purpose of the present study, there is not any practical reason to examine ancient business history; rather concentration must be on the modern MNEs and their historical development. Although earlier MNEs shared certain features with the modern MNEs, the evolutions of the modern multinational enterprise dates back roughly to the last half, or better still the last quarter of the nineteenth century. However, it must be stressed that the modern multinational enterprise is not a post World War II phenomenon in contrast to common public belief.

I want to give some conceptual characteristics of MNEs in order to explain why they need special examination, since they have been under examination of variously specialized scholars for decades, and I want to indicate the conceptual limits of the MNEs for the present research. In a short explanation, the origin of contemporary conceptions of the MNEs lies in the belief that this modern, large-scale capitalist enterprise is a unique phenomenon, different in kind from earlier business organisations such as the partnership and the small firm. Therefore, this new phenomenon needs special examination in order to indicate the differences from the patterns of small firm’s limited models. These differences occur in economic, social, organisational and legal characteristics of MNEs. The present study, principally, shall focus on the differences in

3 Hertner Peter and Jones Geoffrey (eds.), *Multinationals: Theory and History* (Gower, Aldershot 1986) p.1


some aspects of legal characteristics in relation to tort liability. However, economic, organisational and social differences, to the necessary extent, will be examined in order to create better understanding of the legal regulations and proposed solutions to the civil liability problems.

An MNE has two distinctive economic features. First, it organises and coordinates multiple value-adding activities across national boundaries and, second, it internalises the cross-border markets for the intermediate products arising from these activities. Therefore, it is different since no other institution engages in both cross-border production and transactions. These unique characteristics of MNEs led some scholars to call it the most significant class of global networks. Moreover, MNEs are different from government and international organisations in that the management of MNEs is not concerned with the development targets of individual nation-states, regions or territories; in contrast, circumstances and country-specific economic policies of nations determine the outcome of relations with MNEs.

MNEs also distinguish themselves from other types of business enterprises by their main characteristic feature that, as parent companies they exercise control over subsidiary firms that are scattered over several states. In other words, although there are legally independent organisations under the group, the parent company exercises strict control over the subsidiaries. However, this excessive exercise of control and unique organisation of MNEs have undergone changes in the last decades. The changes have taken places in the structure of MNEs towards less-hierarchically structured organisations under which the power of the parent companies has considerably reduced and the organisations have gone in the direction of decentralisation. However, the fact of

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8 Fieldhouse DK, The Multinational, p. 24 (n 7)
9 Dunning JH, Multinational Enterprises and the Global Economy (Addison-Wesley, Wokingham 1993) p. 4
10 Wallace CD, The Multinational, p. 9 (n 1)
being a unique phenomenon under this new organisational structure still apparently exists, even making the phenomenon more interesting to conduct a study on.

The idea of what an MNE consists of is also a challenge for scholars so the limits of the study must be illustrated from this perspective. There is an overwhelming agreement in academia that minority joint ventures, co-operative alliances and networking relationships with other organisations should be considered as part of an MNE’s sphere of influence.\textsuperscript{12} For example, licensing agreements, joint ventures and strategic alliances may give them some degree of control under an organisational structure or influence over the foreign companies associated with these organisations. However, MNEs’ relations and control over a company because of contractual relationship will be excluded from this study. Leaving this for further research, the present study shall cover the liability arising from the ownership relationships under groups of companies. In other words, the examination will be based on the legal bodies under the group that are tied to each other with ownership relationships (joint-stock MNEs); the ownership could be fully, partly or cross-ownership.

At this stage, I want to draw attention to the fact that in the history of ideas, attempts have been made to conceptualise the phenomena that multinational enterprises create. The phenomena were regarded as new without realising that both the phenomena and their images themselves undergo changes in time. This applies evidently to the concept of the MNEs.\textsuperscript{13} Therefore, one should bear in mind that MNEs are neither homogeneous in function nor consistent in character over time. This obliges researchers to undertake further studies over time considering new developments and adopting them into arguments. Since it is the contemporary multinational enterprise organisations under critical examination, the present study claims to have special characteristics.


In order to understand the problems and basic facts of MNEs' tort liability this chapter firstly examines the historical developments of FDI movements in parallel with MNEs' emergence and maturing process from social and economic perspectives. This examination will contribute to understanding the reasons for cross-border investments in the historical order. Moreover, the better understanding of FDI movement and growing direction of MNE developments will help to understand why there are problems in host countries related to the activities of subsidiaries. And more importantly, this part of the study will enable better examination of the efficiency arguments of limited liability theory since it is considered to be the primary trigger for investment for companies.

Secondly, in order to prove the inefficiencies under the laws currently applicable to MNEs, the structural differences in organisation of MNEs will be under critical and explanatory examination. This examination will be crucial for illustrating the need to move from the classical understanding of MNEs' structures in applicable law and proposed regulations. The main reason for examining the organisational structural developments lies behind the fact that as a social institution the regulation of liability of MNEs should be structured according to their organisational structure. MNEs shall be considered as an institution that has certain characteristics which define them and make them different from any other institution in society, such as company, trust or international economic organisations. In particular, this study aims to discuss the liability issues arising from subsidiary activities; in reality there have been many studies in the examination of multinational corporate groups and liability arising from subsidiaries' tortious actions under the group. However all these studies mostly concentrate on one simple type of organisational structure of multinational enterprise, which is vertically organised MNE. The concept of vertically structured MNE can be defined as a group of companies consisting of a parent company and subsidiaries under its apparent control with not much effect on each other's operational decisions. However, for the economic, social and organisational examination of MNE activities, there is growing academic interest in inspection of horizontally structured enterprises. The past studies, in legal approach, have not taken horizontally structured MNEs into their main discussion. Therefore, this study will take these new developments as its main focus of research.
Finally, I examine the emergence of applicable principles of law to corporate groups and MNEs. This examination will be purely devoted to understanding the legal evolution with the developments under the case and statutory law. Limited liability principles will be at the centre of the argument. However, the group of companies’ concept will be examined from different aspects in an extensive way. The aim of this examination is to prove the inefficiency of current legal regulations, which are dependent on historical case and statutory law. Accordingly, the efficiency of limited liability will be discussed under this part in order to indicate the conceptual differences between limited liability company and limited liability MNE.

As a result, the combination of economical, social, organisational and finally legal examination will provide broader understanding of the issues and provide a genuine and efficient background for regulatory efforts. With this examination, I aim to prove that MNEs are representatives of the global economic order; their operational and organisational features are almost the same all over the world because interdisciplinary examination supports this claim. The laws of different states or different regions differ since the social, cultural and traditional features of national states are different. However, it will be amply seen that that in terms of MNEs, the characteristically differences amongst national states are very insignificant and are diminishing fast.

Social and Economic History of Multinational Enterprises

History of FDI and Emergence of MNEs

Firms from Europe and North America began to invest in overseas plantations, mines factories, banking, sales and distribution amenities in large numbers in the first half of
the 19th century. This resulted in a significant growth in the size and number of firms, which can be considered early forerunners of modern MNEs, but these companies cannot be, in actual meaning, considered as a MNE since it is widely accepted fact that the emergence of modern multinationals started in the second half of the 19th century. This was due to effect of the industrial revolution. Prior to the Industrial Revolution, most value added activities initiated by economic entities outside their national boundaries were provoked by three factors. The first was the desire to promote trade and financial activities resulting from the needs of the state or that of individual producers or consumers. The second was to acquire new territories and new forms of wealth. The third was to discover new avenues for the use of domestic savings. Therefore, the first MNEs were mainly resource-based investments with the aim of supplying the home country with food and raw materials and logically; the host countries were mostly colonial countries. However, this pattern changed in the beginning of the second half of the 19th century with the growth of large MNEs both in the United States and in Europe.

The effect of industrialisations and improvements in technology and remarkable advances in domestic and international transport, communications and storage techniques created new market opportunities and led firms to reassess their location strategies. Firms, differently from the earlier factors, started to search new territories for their economic wellbeing. These developments, together with the emergence of professionally trained managers and administrators, led both to a widening and deepening of value-added chains and to a expansion in the transactional division of the manufacturing economy. As a result, combining mass production with mass distribution, they built up a harmonized system of goods flow from raw materials, via

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14 Dunning, Multinational...Global Economy p.99 (n 9)
15 Dunning, Multinational...Global Economy, p.97 (n 9)
16 Jones G, 'The Performance of British Multinational Enterprise, 1890-1945' in Hertner Peter and Jones Geoffrey, Multinationals: Theory and History, (Gower, Aldershot 1986), Wilkins Mira, Emergence of Multinational Enterprise (Cambridge Mass, 1970), and Dunning Multinational...Global Economy p.103 (n 9)
production, to the retailer and final consumers. The implications of these later progresses were truly transnational and consequently, many firms grew into, multi-activity, multi-regional and multi-national units.

In the examination of American developments, one will see that, towards the end of the 19th century, American technology had already overtaken European technology in a wide range of metal using industries and in those utilising mass production practices. Consequently, from the second half of the 19th century MNEs with the power of these new technologies appeared in the United States with extraordinary speed and took their place in the economy in a radical way. On the other side of the ocean, in Britain, the evaluation of multinationals came in a slower, more evolutionary manner.

US firms tried to capitalise on their advantages by stepping up their sales to the UK and thus, the larger ones often moved overseas. They first set up branch offices and warehouses on foreign shores because frequently they found it difficult to export from their American plants; then as demand grew and local tariffs appeared or as shipping costs increased scheduling of flows across oceans became difficult. In these conditions, the firms had two options; one was concluding licensing arrangements with British producer, the other was to set up a foreign manufacturing affiliate. Some companies were not yet open to setting up production affiliates abroad so they chose to contract with their foreign partners. However, some companies went further and set up factories in Britain to produce their products in the domestic territory. After some unsuccessful attempts, United States Singer Sewing Machine can be given as an example of successful foreign direct investment in England. By 1867 the Singer had established its first foreign manufacturing plant in Glasgow and was the first to produce and market a

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18 Dunning, Multinational...Global Economy p.102 (n 9)
20 Nicholas, the Growth, (n 19)
21 Dunning, Multinational...Global Economy p.102 (n 9)
product world-wide under basically the same form and trade name. This gives Singer, perhaps the strongest claim, to being considered the first true multinational. 23

On the other hand, especially British economists regarded outward investment as an expansion of domestic activity, where the interests of investing countries and firms were assumed to match. Thus, for British companies, the process of FDI was slow, and thus, it was only in the 1960s that they made the conversion to a more different range of experience across quite different countries and markets. 24 The main reason for the slow growth in FDI in Britain in 19th century was that many firms, which became multinational before 1914 preferred exporting to, rather than investing in, foreign markets. However, this strategy was blocked by a variety of location specific factors. The spread of protectionism from the late 1870s was a major influence in this context. For that reason, American MNEs and MNEs from some other countries preferred to locate subsidiaries in free trade areas. Britain was the principal free trade area at that time in contrast to the protectionist Continent. 25 That explains why Britain was the first country that American companies chose to invest in.

Therefore, some economists conclude that tariffs were the single most important trigger leading to foreign investment by market seeking British and American MNEs before 1914; second was incentives offered by governments. 26 Another reason depended on competitive strategy to reduce freight and production costs for overseas investment. Moreover, firms engaged in FDI to be near the market and to provide to the specific and special needs of local customers.

From that point one can reach a hypothesis that there were two different kinds of multinational investment before 1914, which were market-seeking investment and

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23 Wallace, *The Multinational* p.9 (n 1)
24 Dunning, Cantwell and Corley p. 26 (n 17)
25 Hertner and Jones, *Multinationals* p. 10 (n 3)
resource-based investment. But it should be born in mind that the reason for investing overseas was prompted by the main principles of capitalism that growing in domestic markets led them to think about overseas options. After companies decided to make cross border investments, comes the time to think about entry strategies to other markets. Consequently, by 1914, both resource-based and market-seeking investments were becoming strongly motivated by the desire to exploit sources of host countries as well as the desire to minimise the uncertainties of intermediate product markets. However, in general, there was little attempt by British- or indeed European- investors to exploit the benefits of using the main sources of countries, while US companies invested abroad to acquire intermediate products for their domestic factories, European MNEs primarily invested in the US to sell to the local market.

In summary, the 19th and the early 20th century witnessed the formation of MNEs from United States and Great Britain, as well as from the several European countries, to conduct large-scale trading operations or to exploit resources and raw materials in Latin America, Africa, Asia and Australia, or even to run public utilities such as tramways or gas and electric works. Beginning in the 1860s, the forerunners of the modern MNEs began to exceed their national boundaries in significant numbers and to establish actual production facilities beyond their own frontiers, and no longer only in the developing world, but also in strong consumer markets.

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28 Dunning, Multinational...Global Economy, p.118 (n 9)
29 Wilkins M, The Growth of Multinationals (Edward Elgar, Aldershot 1991) and Dunning Multinational...Global Economy p. 113 (n 9)
30 Wallace, The Multinational p. 16 (n 1)
Developments between 1918-1960

Both market-seeking and resource-based MNEs declined sharply in the immediate post-war period. The reason for that was the movement of countries toward to more protectionist economies and associating foreign companies with their states of origins. As a result, many firms considered other strategies of international expansion, such as licensing, participation in cartels and joint ventures; this was especially valid for German companies.\(^{31}\) Although the number of new subsidiaries set up by MNEs continued to rise throughout the period; it was only in the 1930s that the value of the foreign direct capital stake exceeded its pre-war figure.\(^{32}\) Only a slight recovery was on the way especially for American companies.

The controversial developments in that time was that although the US was more resource-sufficient than the UK, she had built up a significant stock of FDI by 1914, and by 1939 the value of her foreign manufacturing subsidiaries' output was twice of that her export of manufactures.\(^{33}\) This could be considered the time for the start of American domination because the American expansion was in fact relatively slow before World War I, whereas some very important positions had already been secured by European companies in America.\(^{34}\)

The period between the two world wars was not economically prosperous for companies, nor for the countries. In that time, thus, companies established big trusts and monopolies. By the 1930s large-scale MNEs had become a crucially important institution in all industrially advanced market economies and contemporary MNEs had become a socio-political commonplace.\(^{35}\) However, it must be pointed out that there

\(^{31}\) Hertner and Jones, *Multinationals*, p. 9 (n 3)
\(^{32}\) Dunning *Multinational...Global Economy* p.120 (n 9)
\(^{33}\) Dunning, Cantwell and Corley p. 26 (n 17)
\(^{34}\) Gurak, *Multinational Entreprises* (n 11)
\(^{35}\) Teichova, *Multinationals in Perspective* p. 365 (n 13)
were other important developments in the growing of some technologically developed and high consumer demand so the companies that were concentrated on such kinds of business expanded their development internationally, such as IBM, Unilever, Shell and Esso.36

The main idea for cross border investment was still the same; Europe and USA firms were prompted to establish branch plants mainly by their need to modify goods to local supply capabilities and require power in the market to save on transatlantic transport costs and by the incidence of non-tariff barriers.37 Therefore, what was overwhelmingly important to the MNEs before 1945 is the idea of moving to other countries for basic marketing reasons and therefore it was limited to movements from developed economies to developed economies and usually between neighbour countries or countries which have close relationships for historical reasons. Investments (if we can call it really investment) to less developed countries were mainly investments in colonies. Thus it cannot be considered the same as the modern understanding of foreign direct investment and operating subsidiaries cannot be considered as similar to subsidiaries that exist in the 21st century rather they had branch-like characteristics.

The real expansion in American investment abroad began in the 1950s. America's more pragmatic evaluation than her European counterparts' as well as her rising living standards, her governmental support of foreign investment and her competitive character were all contributory factors for this increase.38 It is for this reason that those who centred in on the multinational phenomenon only in the period of its late expansion, with its readily available statistics, tended to view the MNEs as an American phenomenon.39

36 Wallace, The Multinational, p. 22 (n 1)
39 Wallace, The Multinational, p. 22 (n 1)
Developments between 1960-1990

It must be accepted that, production in more than one country under a common nationality of ownership or control had little importance in the world economy before the 1950s. In explanation, MNE activities as a device for the transfer of resources between countries and as a means of controlling the use of these assets played a less important role in the world economic activities than it had since the mid 1950s and 1960s.

The figure that before 1914 there were more European than American multinationals changed in favour of America after the First World War and especially after the Second World War, and consequently, there was American dominance in the world economy. By 1960, the share provided by the US had jumped to 49 per cent, while that of Britain was down to 16 percent. The recipient areas had also changed markedly, with developed countries now accounting for two-thirds of global FDI, due largely to the substantial growth of US manufacturing investment in Canada and Western Europe in the 1950s.

There was European concern about growing American dominance in world economic activities. In 1968 when Jacques Servan Schreiber published his book *The American Challenge*; he warned Europeans of the increasing domination by US firms in high technology industries in Western Europe. The concern was less with the growing proportion of European production accounted for by US affiliates, and more with the implications of this phenomenon for the long-term competitiveness of the host economies.

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40 Dunning, Cantwell and Corley, p.19 (n 17)
41 Gurak, Multinational Enterprises (n 11)
The concern had its effect and the post-war era of American multinational superiority was challenged after the 1960s. The rise of US’s FDI in the 1950s and 1960s in the 1970s has been matched by an increase in the FDI by West Germany and Japan and West Europeans. Very recently, in 1980s and 1990s MNEs have emerged from some of the newly industrialising countries, e.g. South Korea, Hong Kong and Singapore and China. Related to the trend of FDI being largely between developed countries, cross-investment or intra-industry FDI has emerged. These new economic activities were a comparatively rare phenomenon before 1945. As a result, there was a shift from an American dominated era to a much more complex system of MNEs in which, many nations increased their foreign investments and the United States became the world’s foremost host economy as well as home economy to MNEs.

In that period, the growingly accepted explanation for the foreign production of firms was based on the acceptance that it was a market replacing activity. The investment in production abroad would occur whenever and wherever firms supposed that the net benefits of using cross-border markets to establish new production units abroad. Therefore, in the 70s and the 80s MNEs preferred largely Greenfield investments. However, affiliates were comparatively involved in little innovatory activities and thus they were less embedded in host countries and more importantly they were mainly under hierarchical structures and thus under the strict control of the parent companies.

44 Hertner and Jones, Multinationals p. 2 (n 3)
45 Dunning, Cantwell and Corley, p. 36 (n 17)
47 Greenfield investment can be defined as direct investment in new facilities or expansion of existing facilities. However, the Oxfam approaches definition of Greenfield investment suspicious by defining FDI as a Greenfield investment “when a foreign firm creates a new subsidiary” details at Oxfam America ‘Global Finance Hurts the Poor’ (Oxfam America, 2002)
Contemporary Developments, Globalisation of the World Trade

During the last half century and particularly in the last 3 decades, a new and separately individual vehicle of international economic activity has emerged as a result of the internationalisation of productive activities of many enterprises, the multinational enterprise. Consequently, the modern theory of international production has moved away from a reliance on country-oriented advantages in production towards firm-specific advantages. Thus, the emergence of the truly global enterprise and escalating of all forms of corporate structures is the most marked organisational development of the past three decades.

This fast and nearly completed globalisation of many enterprises is reducing the significance of the nationality of ownership as a feature influencing the contribution of such firms to national economic welfare. In some industrial sectors dominated by global producers, it is becoming increasingly difficult to distinguish between the nationalities of the ownership of value-added activities in any significant way. This mobility, which is currently being dramatically enhanced by the advent of electronic commerce and money, is offering MNEs wider location options in respect of both the creation and use of these assets and products. This makes differentiation of the FDI movement more difficult in the world, particularly between developed countries since exercise of manufacturing in more than one country has become the standard rather than the exception.

Private direct investment by companies from industrialised countries, through legal corporate transactions in other industrialised and less developed countries, has

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49 Dunning, *Multinational... Global Economy* p.130 (n 9)
50 Dunning, *Multinational... Global Economy* p.11 (n 9)
51 Dunning, *The Key Literature* p. 57 (n 46)
52 Wallace, *The Multinational* p. 30 (n 1)
grown by overwhelming proportions in the years between 1946 and the present day; and it has entered the twenty-first century with all the signs of renewed strength. The networks of the MNEs have truly taken on global dimensions, and foreign direct investment has been recognised as an essential element in the economic well-being of both home and host country, as well as in the process of global economic integration that is already well underway. 53

Widespread privatisation and the deregulation of many service sectors have opened up huge opportunities for FDI in the utility, telecommunications and banking and finance sectors. Regional economic integration, especially in Europe, has also increased the ability of MNEs to internalise trade flows. Moreover, one of the most distinguishing features of the new world economy is the ease with kinds of assets and intermediate products that determine a nation's prosperity and growth are able to move across national boundaries. 54 From that aspect as well MNEs remain in a class of unique organisation. And thus, the MNEs, with affiliates in many countries, have rapidly assured its place as "the characteristic industrial organisation of the age". 55 It is already a common practice for a number of MNEs from developed countries to send raw materials or components to certain developing countries for labour-intensive assembling or processing. The products so manufactured are then re-imported into the industrialised countries or exported elsewhere for assembling, finishing or final sale. 56 Therefore, profit-maximising behaviour of the enterprises prerequisite the free flow of the factors of production, both capital or labour, in order to operate at most favourable level with respect of global opportunities. 57

One such conversion since the early post war investment period is that it now relies less on removal, processing and transport of raw materials and looks more to modern technologic and scientific processes of diversifying production. The degree of

53 Wallace, *The Multinational* p. 31 (n 1)
54 Dunning, *Multinational...Global Economy* p.129 (n 9)
55 Wallace, *The Multinational* p. 30 (n 1)
56 Gurak, Multinational Enterprises (n 11)
openness in international trade has surpassed the pre World War One record levels in many countries with the consequence that growth in international trade is stronger than the growth in world production. In particular, the growth of foreign portfolio investment, mergers and acquisitions, strategic alliances and a host of network relationships have been particularly impressive over the last two decades.

Multinational expansion in the field of financing production from pre-financing to credit-financing to self-financing of subsidiaries abroad, and finally, the progression in the sphere of finance from the old means of private banking to the new means of investment banking and to multinational banking created easily available funding for the companies who wanted to expand their operations in cross border ventures. Consequently, medium sized enterprises have also internationalised and are being integrated into production and distribution networks in which the distribution and manufacturing of goods are globalised. The internalisation of medium sized enterprises is also challenging the borders of legal systems that regulate the area.

All these economic developments generated new movements in the world’s economic order in the last two decades. The communist block has collapsed and countries from the block opened their public companies for privatisation. Not only these countries but also most of the less developed countries aim to attract more FDI. They try to reduce legal and economical barriers for MNEs in order to encourage them to invest in their territory. They invent different kind of incentives for MNEs and there is a battle to make the best offers for MNEs amongst less developed countries. Shortly, the

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57 Gurak, Multinational Enterprises, (n 11)
58 UNCTAD, World Investment Reports, 1993-2003
59 UNCTAD, 1993-2003, (n 58)
61 Charlton, Incentive Bidding, (n 60)
last two decades as well witnessed the gradual reduction of trade barriers, which are welcomed by the MNEs.  

According to World Investment Report (WIR) 2006 of UNCTAD, the global stock of FDI in 2005, owned by some 77,000 transnational corporations and their 770,000 of their foreign affiliates is $9 trillion. FDI continues to be more important than trade in delivering goods and services abroad: global sales by MNEs reached $19 trillion in 2004, as compared with world exports of $8 trillion in 2002. Companies are still continuing to invest abroad and FDI outflows increased in 2005 by 27% to $916 billion and these MNEs are almost all from developed countries. Firms from developing countries accounted only for $117 billion. MNEs employed more than 62 million people abroad. All these figures led to another definition for multinationals that of “foreign direct investment entity”.  

Also, interestingly, MNEs from the EU have become by far the largest owners of outward FDI stock, some $3.4 trillion in 2002, more than twice that of the United States ($1.5 trillion). In developing countries, the inward FDI stock came to nearly one-third of Gross Domestic Product (GDP) in 2001. The single market is expected significantly

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63 UNCTAD, World Investment Report 2006 p.5  
64 UNCTAD, 2005, p.4 (n 63)  
65 UNCTAD, World Investment Report 2006 p.1  
66 UNCTAD, 2006, p.2 (n 65)  
67 UNCTAD, 2006, p.5 (n 65)  
69 UNCTAD, World Investment Report 2002  
70 UNCTAD, World Investment Report 2003, p. 14
to affect investment flow into and within the EU.\textsuperscript{71} These figures are expected to grow in number at the beginning of the 21\textsuperscript{st} century.\textsuperscript{72}

The globalisation of FDI movement has not changed the fact that the most powerful MNEs are from developed countries since among the top 100 companies only 5 are from developing countries.\textsuperscript{73} Another interesting statistics as well relates to financial MNEs; financial MNEs from France, Germany, Japan, the United Kingdom and the United States accounted for 74\% of the total assets of the top 50 financial MNEs in 2003.\textsuperscript{74} Accordingly, less developed countries continue to adopt new laws and regulations in order to attract more investment into their countries. There were 235 changes in laws alone in 2004 to open up borders to MNEs and introduced new promotional measures for MNEs.\textsuperscript{75} In addition 20 countries lowered their corporate income tax.\textsuperscript{76}

These figures indicate that the key to MNEs movement and behavioural policies is found in developed countries since developed countries host the biggest MNEs and as well have significant financial resources. Thus, the less developed countries have to be involved in a bidding war to attract MNEs by introducing foreign investment laws as well as reducing their regulatory schemes.\textsuperscript{77} In those conditions, it is not realistic to expect countries to increase regulations on MNEs; indeed it is often very difficult to keep existing regulations. Accordingly, in these loose regulatory environments, companies are almost free to move from one jurisdiction to another one with little problem or little loss of profit.

\textsuperscript{71} Muchlinski, \textit{Multinational} p. 31 (n 38)
\textsuperscript{72} The figures from WIRs are given as examples to indicate the scale of global economic activities of MNEs. However, there are criticisms that these figures are not trustable; for example the restructuring of Royal Dutch Shell in 2005 created a $74bn inward flow of investment from Netherlands to the UK without a significant change for the UK or Dutch economies. \textit{See Financial Times} (London, October 17, 2006)
\textsuperscript{73} UNCTAD, \textit{World Investment Report} 2006, p.6
\textsuperscript{74} UNCTAD, \textit{World Investment Report} 2005, p.4
\textsuperscript{75} UNCTAD, 2005 p.8 (n 73)
\textsuperscript{76} UNCTAD, 2005 p.8 (n 73)
The increasing effect of the global regulatory actors on international trade is another development in the world economy. The escalating instability of financial and exchange markets, and the changing architecture of supranational institutions such as the WTO, World Bank and IMF, affect MNEs' ability to organise and move their products and capital across the globe. The aim of these institutions is always to open boundaries and reduce limitations so it is a common conditionality for countries who ask for credit or be accepted into memberships to open their boundaries to MNEs.

In the inner organisational structure of MNEs, the challenges of an innovation-driven economy and the emergence of new forms of international business activities, together with the increasing instability of many cross-border transactions led to new understanding of organisational structures for MNEs. It is forcing entities to rethink the roles played, and the relationships between the numerous decision-taking entities comprising these enterprises. As a result, there are systematic approaches to organisation of MNE activities, alternative modalities often harmonising with each other and more institutional pluralism. Considerable foreign based innovatory activity with or without strategic alliances with foreign firms have been achieved. As a result in MNE organisation, there are flattened pyramids; more heterarchical structures; more delegation of responsibilities to line subsidiary managers. These new organisational models make MNEs movements and organisations more challenging and more efficient allowing them to control world economic activities better and on a more global scale.

Theories of Multinational Investment

At this stage, a close look at the earlier determinants of MNE activities is necessary because the time of emergence of early MNEs and the acceptance of the long time

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77 Charlton, Incentive Bidding, (n 60)
79 Dunning, The Key literature, p. 48 (n 46)
debated limited liability theory came at the same time. Thus, the more we understand the drive behind investment decisions, the better proposals for regulations we can produce.

The basic economic explanation for FDI lies in the natural evaluations of firms, which requires them to search for alternatives.80 The firms run through opportunities in domestic markets before going for new adventures abroad in order to search for international opportunities for their value added activities.81 Shortly, once firms develop ownership advantages, international investment theory tells us that a particular combination of location, marketing and knowledge-transfer factors makes foreign production almost inevitable.82

Therefore, after looking at the traditional explanations for the emergence of MNEs, one sees that investment theory connects the theory of the firm and location theory.83 The enterprise, possessing certain firm-specific assets, finds some costs advantages in internalising the use of these assets within the organisation on a cross-border basis. Consequently, the location incentives to establish operations abroad may derive from tariff or non-tariff barriers which act as deterrents to trade, lower unit labour costs, or host government policies such as offers of investments incentives or nationalistic procurement policies which favour enterprises located within the market.84

The location differences can simply be explained by the fact that the supply of some goods is found in one location and demand for them in another. However, geographic expansion of markets also allows more benefits for the firms; more productive division of labour, gains from specialisation, exploitation of differences in resource contribution, and adaptation of skills can be mentioned as some examples for

80 Lall Sanjaya, the New Multinationals: The Spread of Third World Enterprises (Wiley, Chichester 1983) p.68.
81 Caves, Multinational...Economic Analyses p.59 (n 12)
82 Lall, New Multinationals p.69 (n 80)
83 Caves, Multinational...Economic Analyses (n 12)
the locational benefits of investment. Another locational influence on why companies see foreign countries as having better and more benefit creating opportunities lies in the technological developments in home countries. Their power and technological superiority enables MNEs to suppress the domestic market easily, rather than competing at home with other powerful companies and being exposed to severe price cuts and so on. Furthermore, the technological developments show their effect on management of companies since the growth due to the application of new technology and of management skills extends effective control and supervision of foreign subsidiaries to marketing, distribution, purchasing, facilities, personnel, production units and research and developments encouraging companies to go for FDI with fewer risks.

At the firm level, size of firms has been found to have a strong and independent positive effect on internalisation. Clearly while size reflects the influence of factors which create entry barriers at the industry level, it also acts as a powerful source of monopolistic advantage on its own providing privileged access to capital markets, to information, to production factors, and government favours. When natural power has emerged in the firm, how a firm reacts to the random opportunity for direct investment depends on a scale of economics and market knowledge. It also depends on how the opportunity is perceived in the hierarchy of the firm and the response by management. This makes firm basis advantages less predictable and dependent on other conditions.

The inefficiency of exporting was also a reason to search for cross-border investment because one of the earlier actual physical expansions abroad, beyond mere export or licensing, was the realisation that foreign markets' needs could perhaps be more effectively assessed and met by an on-the-spot manager, who could better

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86 Fieldhouse, Multinational...a Critique p. 14 (n 7)
87 Teichova, Multinationals in Perspective p. 366 (n 13)
88 Teichova, Multinationals in Perspective p. 366 (n 13)
89 Nicholas S, 'The Theory of Multinational Enterprise as a Transactional Mode' in Hertner Peter and Jones Geoffrey, Multinationals: Theory and History, (Gower, Aldershot 1986) p.76
understand the local consumer, than by a long-distance counterpart. The financial advantages of manufacturing in a foreign market closer to the target consumer were also discovered.

Of course, during the history of foreign direct investment, the motivations for cross border investments have shown various different characteristics. For example, one of the earliest motivations was the desire to control sources of raw materials, which explains why historically multinational operations developed in the extractive colonised areas before becoming involved in manufacturing. Therefore, Professor Dunning claims that it is not possible to produce everlasting certain theories for multinational investment. He puts firm specific and location specific advantages together and explains investment theory under the name of eclectic theory that is a combination of three inter-related factors: first, the competitive (firm specific) advantages of existing or potential MNEs, second, the location advantages of particular countries in offering complementary assets, for these advantages to the exploited or amplified, and the tendency of the firms possessing the ownership specific advantages to combine these with those of foreign based assets, by FDI, rather than by the market mechanism, or some kind of non-equity cooperative project.

The country specific conditions as well had an important role for searching out overseas investment. At a time when Americans moved to internationalisation, this movement was greatly stimulated by the Sherman Act of 1890. Although at home they were restricted by antitrust regulations, American companies were entitled to use whatever methods were necessary to conduct foreign trade. Consequently, the current

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90 Wallace, *The Multinational*, p. 18 (n 1)
91 Wallace, *The Multinational*, p. 18 (n 1)
92 Dunning, The Key literature p. 43 (n 46)
93 Dunning, The Key literature p. 43 (n 46)
95 Wallace, *The Multinational*, p. 20 (n 1)
analysis of MNEs argues that direct foreign investment is based upon certain monopolistic advantages possessed by firms.96

Indeed the early process of expansion of firms to national-market figures in the nineteenth century in the US economy was quite similar to their transformation to multinational status more recently.97 We have evidence on the behaviour of early MNEs such as Singer Sewing Machine Company, which became foreign investors through a process of incremental problem solving, such as dealing with the unsatisfactory performances of foreign licensees or sales agents. The historical case studies also illustrate that the evolution of the decentralised multi-plant and multinational firm depended on the need for economic efficiency for the firms.98

Evaluation of Social and Economic Characteristics of MNEs

Since their emergence, MNEs have been one of the few principal institutions affecting the formation and outcome of all kinds of economic relations; the other important institution has been the states. The powerful role of the MNE in the contemporary global economy reflects their capabilities and willingness to organise, for good or bad, cross-border production and transactions more effectively than any alternative institutional mechanism.99 In the last two decades, MNEs’ activities have played an important role in the globalisation processes of the world’s economic activities.

As a result, the 21st century can be described as the era of the emergence of truly globalised MNEs and the real and more effective freedom of movement of capital between countries, if it is not completely free. Moreover, in economic characteristics,

96 Lall, New Multinationals p.1 (n 80)
97 Nicholas, Theory of Multinational, p. 64 (n 89)
98 Caves, Multinational...Economic Analyses, p.61 (n 12)
99 Dunning, Multinational...Global Economy, p.133 (n 9)
from a relatively simple vertical set of control procedures designed to support market transactions and resource seeking foreign investors, the MNE has evolved into a complex hierarchy of a network of vertical and horizontal intra and inter-firm connection aimed to carry on its global and regional objectives. Thus, these new type of MNEs, while investing, think about cost-effective structure of profit maximisation- rather than market entry models of 19th and early 20th century multinationals.

This movement from market orienting types MNEs to cost effective MNEs created more problems in the less developed countries because of the inadequate laws of these countries and, in contrast, their need for FDI in order to develop. The MNEs have abused these weaknesses to secure many unjustifiable incentives from the governments. Also, the competition for attracting more FDI in less developed countries weakened the legal protection of their citizens in relation to MNEs. This makes already weak legal systems non-working since capital and economic organisations are easily movable from one country to another, less developed countries are afraid of deterring MNEs’ investments in their countries. This situation creates severe competition amongst countries to attract more FDI and thus makes the country regulations very lenient, even worse, forces them give judicial incentives to MNEs for their activities. This forces to give incentives and exemption for multinationals in host countries, sometimes suggestive of the old colonial era.

On an economic basis, the very idea of a national market as an economic construct appears to have lost meaning in the post-modern world economy. Given the emergence of globalisation in every area of business, neither territoriality nor mutually

100 Dunning, Multinational... Global Economy p.232 (n 9)

101 Under the project of the Baku-Tbilisi-Ceyhan Pipeline, some restriction have been introduced for the governments not to change the law or make not applicable further changes of the law for the BTC consortium under which BP is the largest stakeholder and leading the design and construction process. For more details see Amnesty International “Human Rights on the Line” http://www.amnestyusa.org/business/humanrightsontheline.pdf accessed 22 June 2006. See also, Lawson-Remer TE, ‘A Role for the International Finance Corporation in Integrating Environmental and Human Rights Standards into Core Project Covenants: Case Study of the Baku-Tbilisi-Ceyhan Oil Pipeline Project’ in Schutter OD (ed.), Transnational Corporations and Human Rights (Hart Publishing, Oxford 2006)
exclusive geographic organisation retains significance. The result has effects that raise questions about the meaning of sovereignty of national states in a global system that gives the MNEs the power to operate all over the world.

Currently, with the progressive reduction of tariff and non-tariff barriers through the GATT/WTO mechanism, one of the dominant factors influencing investments abroad has simply come to be the need to gain and safeguard access to local and regional markets. These new organisational and structural changes in world trade ease cross border investment by creating more benefits, but making the competition for attracting FDI more severe for the host countries. Free trade zones like European Union and NAFTA are also determinant bodies for the 21st century’s international trade.

Consequently, nation states have contradictory interests and objectives in their relations with MNEs. Some states are powerful enough not to compromise the civil and social rights of their citizens, while other might be desperate for FDI and thus more open to compromise about the civil and social rights of their citizens so national boundaries, in this sense, still create significant differentials on the global economic surface. The critical point, however, is that globalisation implies that the national economy is no longer the unit of economic accounting or the frame of reference for economic strategies. The new structures and strategies in MNEs governance operate in accordance with the rules of globalisation. This leaves least developed countries dealing with issues that they have no power to change.

The firm specific organisation has changed the MNEs’ social position. They are not simply groups of companies anymore; they are one of the most important economic and financial determinants of the world economy. They are known separately from their

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102 Kobrin, The Architecture of Globalisation, p. 159 (n 85)
104 Weiler JHH, The EU, the WTO and the NAFTA; Towards a Common Law of International Trade Regulation (Oxford University Press, Oxford 2000)
country of origin; they might be bargaining with the national states independently from their national states. Actually, it is almost impossible identifying them with a nationality since their assets and origins might be scattered all-over the world. This indicates another misconception of the problems from social theory that MNEs are controlled and they operate under very control of the states. Indeed, states are becoming dependent on MNEs’ control.

Accordingly, the law making bodies have failed to react to challenges in the modern theory of international investment from a reliance on country-oriented advantages towards firm-specific advantages. International private law still basically depends on the law of individual equal states, even though some bilateral harmonisation has been achieved, especially under European Union Law. These country specific regulations show very limited characteristics under company and tort laws. On the other hand, international regulatory activities have concentrated on creating a more comfortable atmosphere for the MNEs, such as in tax and corporate governance. The improvements in the last two decades in international trade are impressive. The new and powerful transformation of GATT to WTO is progressing very fast. The free trade-agreements are emerging everyday between developed countries and developing countries. The governments and international financial institutions seem to heavily devote themselves to easing the trade barriers across borders. All these mean more powerful, bigger and wider spread MNEs influence. In contrast, the liability for company groups is still regulated by 20th century’s narrow understanding of company law based on a limited liability company as a principal. This lack of sound regulations is common between common law and continental law.

At first sight, the main obstacle to the regulations seems to be limited liability rules. However, the examination of multinational investment theory and an historical approach has proved that the relation between limited liability and a company’s

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105 Kobrin, The Architecture of Globalisation, p. 154 (n 85)
investment decision is not certain. The examination of economic triggers for foreign investments as well shows no coincidence with the prosperity that limited liability is claimed to create. In fact it is difficult to find any attempt to examine thoroughly the reasons why MNEs decided on different strategies once the decision to undertake FDI had been made. The reasons why some firms made Greenfield investments and others purchased existing firms, and why some firms established wholly-owned subsidiaries and others joint ventures, remain vague. Actually small and medium sized enterprises choose joint ventures while big multinational have chosen direct investment and therefore establishing subsidiaries, mostly wholly owned. This proves that establishing a subsidiary under entity law for MNEs is due to the effects of economic and financial evaluation rather than incentives provided by the limited liability company.

In any explanation of the economic theories of multinational enterprise, the advantages of limited liability company are mentioned. The studies that have examined some particular countries have proved that there is no certain relation between the decision of investment of the firms and the limited liability of corporate shareholders. Even the modern investment theory provides little guidance on the factors influencing the allocation of resources when neither law nor custom prevails. Successful cross-border activity requires a combination of skills; the ability to identify profits opportunities, the judgment to evaluate them, and the tactical awareness to exploit them properly. In other words, it depends on the practical reality of international

107 Detailed discussion is made at Chapter 3.
108 Hertner and Jones, Multinationals p. 10 (n 3)
111 Casson M, 'General Theories of Multinational Enterprise: Their Relevance to Business History' in Hertner Peter and Jones Geoffrey, Multinationals: Theory and History, (Gower, Aldershot 1986) p. 55

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This proves that the understanding of the legal factors to the growth of MNEs is much less advanced than economic theory.\textsuperscript{113}

The Changes to Organisation and Management Structures of Multinational Enterprises

Need for Examination

There is a growing expectation in business and MNEs studies to examine the structural changes in MNEs because examination of the issues only on the basis of the simplified structure of MNEs is far from creating sound solutions to the problems. Therefore, this study includes examination of horizontally structured MNEs, and then, will clarify the situation and will create more efficient ways of thinking. The need to examine the organisational structure of business organisations lies in the fact that if we wish to develop an adequate economic as well as legal theory of the modern business enterprise and the contemporary economic activities of them, we must begin to build an sufficient sociological and economical understanding of business organisations and build new laws on these facts.\textsuperscript{114} In other words, at this stage if one wonders why the structure of organisations has become the centre for discussions of legal theory, the answer lies in the realities of globalisation that turned FDI and consequently international business activities towards a firm-based model rather than country based model.\textsuperscript{115}

\textsuperscript{112} For example, it is still possible to establish unlimited liability company in England. Moreover, German and Turkish laws have company forms with unlimited liability.

\textsuperscript{113} Muchlinski, \textit{Multinational} p. 37 (n 38)

\textsuperscript{114} Scott John, ‘Corporate Groups and Network Structure’ in McCahery J, Picciotto S and Scott S, \textit{Corporate Control and Accountability} (OUP, Oxford 1993)

Although the changes during the history of MNEs and its reflections have been to some extent, observed and indicated in major economic, managerial and business studies, the history of the multinational enterprise studies from a legal perspective is based on the common misconception of economic analysis and its effect on law making. It has stayed on the same assumption that economic analysis traditionally treated the MNE as a single decision-making centre, as if one mind were absorbing all relevant data and making all decisions on the basis of well-considered purposes. In fact decision-making is decentralised within firms, and decisions can be highlighted by the structure of the internal organisation chosen by the firm and the incentives and the resources that it provides to its various groups of practical specialties.116

This need leads us to the aim of the thesis that is to examine the framework of progressed and differentiated organisation forms and to link this framework to an elaborated theoretical analysis of the other historical fields of organisation theory. This assessment will indicate how and to what extent business organisations have changed during the past century.117

The reason behind the new organisational structure is the same as the reason for emergence of MNEs; economic motivation and the economic background for the world business activities have changed.118 The inspiration of groups of companies expanding overseas has increasingly shifted from one focused mainly on securing new markets or low-cost productive contribution, to a universal search for essential intelligence or limited competencies not readily available or very costly in the home market.119 Barlett and Ghoshal accurately point out that the need to secure key supplies of raw materials,

116 Caves, Multinational...Economic Analyses p.57 (n 12)
117 Dunning, Multinational...Global Economy p.215 (n 9) Professor Dunning here explains on which conditions an MNE will structure itself. And, in general, the more numerous and complex the technologies required producing a particular product and the more products supplied by firm, the more complex its organizational structure is likely to be.
to acquire new markets, to achieve further sales and to access low-cost factors of production such as cheap labour or low-cost capital comprised the earlier foreign investment inspiration. At an early stage MNEs and foreign operations were regarded as organisational additions or as distant settlements to the domestic business and treated in an opportunistic rather than a strategic approach.

A common subject in all the discussions of organisational theory has been the remarkable changes in the competitive environment that have reduced the effectiveness of traditional MNEs' approaches, highlighting the need to move towards less-hierarchical structures because of their experience in the international operating environment. MNEs that do so develop the best chance of existing. Thus, they search for the most efficient operating environments, which basically depend on profit maximisation. As a result from an evolutionary perspective, there has been a shift in focus from measurement within traditional vertical models to movement toward the horizontally structured MNE models under which they can have the best chance to maximise the profit.

On this point Barlett and Ghoshall conducted the most important studies resulting in findings that large global corporations are creating a new organisational model in the 1990s that is significantly different from the multi divisional form (M-form) and its previous shapes of organisation that had dominated corporate structures over the last five decades and that had provided the background for much of present organisation theory. This movement in structure is not surprising because there had always been

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120 Bartlett and Ghoshal, The Evaluation of Transnational, p. 110 (n 119)
122 Bartlett and Ghoshal, The Evaluation of Transnational, p. 108 (n 119)
differences within the broader M-form model as well. There had been constant changes in structures of companies and groups of companies and MNEs since their first emergence. All these evolutionary developments have led to the claim that the modern theoretical perception on MNEs as differentiated networks of subsidiaries is the proper academic background to understand the global organisations of MNEs.

However, one should bear in mind that each enterprise is, to some extent, unique and usually holds a combination of different organisational structures. Moreover, the most favourable, or supposed most profitable organisational structure of any particular MNE may change over time. We will see these changes apparent in the assessment of structural changes of MNEs. Actually, the argument pursued in this thesis depends on the fact that evolution of the organisational structure of MNEs has been changed over the last century from vertically structured organisation towards horizontally structured organisations. Therefore, this study in its overall perspective will not exclude the examination of vertically structured MNEs; it will, to some extent, compare the different structural models and their reflections in law.

The Historical Developments of MNEs' Organisational Structures

In an historical perspective, one of the most significant factors in the rise of MNEs has been the development of concentration on organisational structure. The constant impact on the structure and organisation of business became obvious from the last quarter of the 19th century and this led the growth of large companies, which gradually increased their market shares at home and abroad, and lately stood at the centre of considerable merger,


126 Tavares, Strategic Management, (n 118)

127 Dunning, Multinational...Global Economy, p.215 (n 9)
acquisition and other strategically motivated movements. In early stages of emergence of enterprise, when an enterprise becomes an authority and director and controller of the actions of participating organisations, a plain hierarchy develops. The central position of the enterprise and the personal relations make the authority the most important co-ordination mechanism used in this form and creates a distinctive atmosphere that is simple and possible for a single centred enterprise to operate.

As the enterprise grows in an environment that is steady and thus projected, new forms may develop. This happened when MNEs were too big to be controlled by simple hierarchic structure and the unitary form (U-form) has been developed. The U-form modifies the co-ordination by authority by introducing several levels of management and separates practical responsibilities among managers at the same level. The U-form is also characterised by the introduction of a new important co-ordination mechanism, which can be defined as advanced rules for the organisation. This new form is coordinated by formalised procedures, by precise, written instructions for work performance and systems for planning and control. The U-form was a modernisation that developed earlier forms, suitable for small and medium sized companies and it reduced operation costs for co-ordination in large dimension, mass-production units by function, using a multilevel hierarchy with professional managers and relying on broad formalisation for management.

After passing through stages of quantity expansion, geographic dispersal and vertical integration, companies finally grew by product diversification, experienced administrative problems within the functional structure of U-form and converted to the M-form, the multidivisional structure, to resume profitability. The natural weakness in the unitary formed companies became significant only when the administrative load on the senior executives increased to such an extent that they were incapable to handle their

128 Teichova, Multinationals in Perspective, p. 365 (n 13)  
129 Williamson, Markets and Hierarchies, (n 125) and Chandler AD, Scale and Scope: The Dynamics of Industrial Capitalism. (Harvard University Press, Cambridge 1990)  
entrepreneurial responsibility efficiently.\textsuperscript{131} This situation arose when the operations of the enterprise became too complex and the problems of coordination, assessment, and policy formulation too compound for a small number of top officers to handle long-term, entrepreneurial, and short-run operational administrative activities. In order to overcome these challenges, the innovators built the multi-divisional structure with a general office whose management would focus on entrepreneurial activities and with autonomous, fairly self-contained operating divisions whose managers would handle operational ones.\textsuperscript{132}

The M-form can be explained as a development from the U-form, as the U-form grew into differentiated businesses, new products and markets.\textsuperscript{133} The M-form is characterised by a separation into semi-autonomous units with responsibilities for results, creating medium-sized corporations within the large enterprise.\textsuperscript{134} Whereas the principal operating units in the U-form enterprise are the functional divisions, in the M-form enterprise, these are half-autonomous operating divisions.\textsuperscript{135} Another characteristic is that the responsibilities are divided vertically in the hierarchy. The M-form separates top level from middle levels and gives the top-level strategic responsibilities. The middle level is divided into divisions and each division is given responsibilities for certain front line units. Divisions are given decentralised responsibilities for their own operations while for the overall strategic decisions are made at top-level.\textsuperscript{136}

\textsuperscript{132} Gooderham and Ulset, Beyond the M-form, (n 121)
\textsuperscript{133} The M-form was characterised as multi-divisional, multi-product, multi-factory, multi-level, multi-hierarchical and multi-national.
\textsuperscript{134} Gooderham Paul N and Ulset Svein, 'Is the Governance of Transnational Really "Beyond the M-Form"? A critical Review of Bartlett and Ghoshal's New Organisational Model' in Taggart H, Berry M and McDermott M (eds.), \textit{Multinationals in a New Era} (Palgrave, London 2001) They explain the terms of M-form optimum divisionalisation involves 1- the identification of separable economic activities within the firm 2- according quasi-autonomous standing (usually A profit centre nature) to each 3- monitoring the efficiency performance of each division and awarding incentives 4- allocating cash flows to high-yield uses 5- performing strategic planning in other respects.
\textsuperscript{135} Gooderham and Ulset, Beyond the M-form, (n 121)
The multi-divisional structure solved the overload and governance problems of the U-form by decomposing the larger enterprise into a number of half-independent divisions; profit centres, product, brand and geographical lines, and by separating strategic decision making at the corporate level from operating decision-making at the divisional level that have responsibility for different markets or products, rather than functions. MNEs were transferred to M-form because, as Chandler's central discussion claims MNEs being driven by market growth and technological change to develop greater diversity in their products and markets, were able to manage their new strategies efficiently only if they were adopted a multidivisional organisational structure.137 As noted by Williamson the M-form not only replaced the less efficient U-form structure but also was consequently extended to manage diversified assets -the conglomerate- and foreign direct investments -the multinational enterprises, together that made the M-form considered the genuine and standard models for MNEs.138

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137 Williamson, *Markets and Hierarchies*, (n 125) and Chandler, *Scale and Scope*, (n 129)

138 Gooderham and Ulset, *Beyond the M-form*, (n 121) and Williamson, *Markets and Hierarchies*, (n 125)
The more complex matrix structure of M-form was developed in order to meet expectation in business in the second half of 1970s. In the Matrix structure two, or more, divisional structures are combined, for example divisions by products and division by geographical markets. This dual structure embraces the whole company and is stable over time.\(^{139}\) In addition to the matrix, an alternative way of achieving the dual advantages of global standardisation and national openness is the regional approach. By designing and implementing competitive strategies within a region, the MNE may overcome some of the very real staffing, communicational and motivational problems associated with the global approach.\(^{140}\) The regional approaches to organisation occurred in a way that MNEs set up regional centres that undertake some of the tasks of the centre so that there is a better communication amongst the units of the organisation and more diverse and efficient allocation of staffing and financial sources.\(^{141}\) These organisational structures were developed because of the inadequacy of the alternatives to solve the problems that more globalised business environments raise. Moreover, the matrix and regionally structured organisations have initiated examples of the first transformation to the horizontal structure.

In summary, before the final stage of developments in the last century, we can divide the organisation of multinational enterprises into some stages.\(^{142}\) First, most MNEs go through an initial period with relatively autonomous foreign subsidiaries that are tied to the parent company by financial and managerial links in a way like in a holding company. Second, this unstructured system of subsidiaries was successful for some time, but if the subsidiaries grew rapidly and accumulated resources, pressures to increase control emerge at the headquarters as the international division increases in dimension. Top managers recognised a need for a worldwide perspective and thus, a need for a global structure. This resulted in the way of developing the U-form and later

\(^{139}\) Bartlett and Ghoshal, Beyond the M-form, (n 125)

\(^{140}\) Marschan Rebecca, New Structural Forms and Inter-Unit Communication in Multinationals (HSEBA Publications, Helsinki 1996) p.6

\(^{141}\) The later form of regional organisation, regionally organised horizontal MNEs is examined below. (p 81)

\(^{142}\) Alarik, From M-form, (n 130)
evolved to the M-form. When both foreign sales and foreign product diversity are high, some companies adopt a new structure, the global matrix structure.

Figure 2: The Process towards Less-Hierarchical Structure\textsuperscript{143}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{structure_diagram.png}
\end{figure}

Number and dispersal of foreign subsidiaries

The structure indicated above was the general environment before the business was more complicated and more globalised. New information and communication technologies, the liberalisation and globalisation of markets, the integration of different products increased uncertainty in many industries and increased volatility in the last two centuries brought new way of designing organisational structure. The new structure was innovative and changed many basics characteristics of organisations of MNEs.

**Horizontally-Less Hierarchically- Structured Multinational Enterprises**

A new generation of scholars, the process school: Barlett. Ghoshall. Doz. Prahalad. Hendlund and the others dominated the international business organisation arena since the middle of the 1980s. They claimed that the structure of MNEs was changing. They
do not only conserve to have discovered the emergence of an organisational model but also claim to having contributed to a new concept and a new organisational theory of the MNE.\textsuperscript{144}

A contributing factor to the increasing use of new structural mechanisms in MNEs is that classic mechanisms -M-form and Matrix- alone are considered incapable of capturing the turbulence of today's competitive environment.\textsuperscript{145} Accordingly, horizontally structured organisation system is a creature of the information age: post-modern organisations held together by information technology.\textsuperscript{146} This is a complete new era for humanity and human relations and, as happened in the past, new types of organisational structures have been developed to meet these new challenges.

The studies were from many different institutions in a short time. This proves that the changes were realised by many scholars. Different names are used to describe the new organisation type, geocentric\textsuperscript{147}, dynamic network\textsuperscript{148} heterarchy\textsuperscript{149} transnational\textsuperscript{150} integrated network\textsuperscript{151} horizontal\textsuperscript{152} multi-centre\textsuperscript{153} integrated players\textsuperscript{154} wired\textsuperscript{155}

\textsuperscript{143} Adapted from Marschan, \textit{New Structural Forms}, (n 140)
\textsuperscript{144} Alarik, From M-form, (n 130)
\textsuperscript{145} Marschan, \textit{New Structural Forms}, p.31 (n 140)
\textsuperscript{146} Kobrin, \textit{The Architecture of Globalisation}, p. 153 (n 85)
\textsuperscript{147} Perlmutter HV, ‘The Tortuous Evolution Of The Multinational Corporation’ (1969 Jan-Feb) Columbia Journal of World Business 9
\textsuperscript{148} Miles RE and Snow CC, ‘Designing Strategic Human Resources Systems’ (1984) 13 Organizational Dynamics 36
\textsuperscript{151} Bartlett and Ghoshal, Beyond the M-form, (n 125)
\textsuperscript{153} Forsgren M, Holm U and Thilenius P, ‘Network Infusion in the Multinational Corporation’ in Bjorkman I, Forsgren M, \textit{The Nature Of the Transnational Firm} (Handelshonjskolens Forlag, Copenhagen 1997)
transcontinental\textsuperscript{156} multidimensional\textsuperscript{157} N-form\textsuperscript{158} integrated global, network-based\textsuperscript{159} metanational\textsuperscript{160} differentiated network\textsuperscript{161} individualised enterprise.\textsuperscript{162} These names are differentiated on just very small differences in perceptions of the facts. I want to name the new organisational type as horizontally structured multinationals or less-hierarchical multinationals.

For the purpose of the present study, there is no need for detailed discussion of the definition under each study; rather, leaving this ongoing study to the scholars in the management field, the thesis focus on the common characteristics of horizontal structures and their reflections in practice. The above mentioned researchers share a general view about the organisational evolution in MNEs; their structures are becoming less- hierarchical. The fact that top management of several MNEs have had to reconsider the long-standing principle that "the parent always knows the best" has required an essential change in the way the entire group is managed, turning it from a hierarchical pyramid into an integrated network of horizontally structured enterprises.\textsuperscript{163}

The spreading of the sources, managerial capabilities, and strategic and operational decision making throughout the organisation in the new structure expanded the

\textsuperscript{155} Hagstrom P, 'The "Wired" Multinational Corporation: The Role of Information Systems for Structural Change in Complex Organizations' (Ph.D., Stockholm School of Economics, 1991)

\textsuperscript{156} Humes S, \textit{Managing the Multinational Confronting The Global-Local Dilemma} (Prentice Hall, New York 1993)


\textsuperscript{159} Malnight, The Transition, (n 123)


\textsuperscript{162} Ghoshal S and Barlett CA, \textit{The Individualized Corporation} (Harper Collins Publishers, New York 1997)

\textsuperscript{163} Marschan, \textit{New Structural Forms}, p.5 (n 140)
possibilities for foreign subsidiaries to both exploit and create firm-specific advantages, and thus play a greater and more active role in the success of MNEs. It also creates a more effective organisation of knowledge, innovation and technological growth in international MNE organisation.\textsuperscript{164}

By decentralising assets and resources into these small, specialised operating units, these companies are trying to create an environment in which this scarce knowledge can be developed and applied most appropriately. However this creates a greater need for a powerful horizontal integration processes to ensure that the entire organisation benefits from the specialised resources and expertise developed in its entrepreneurial units.\textsuperscript{165}

The transition between decentralised and network-based approaches must be considered as well. This involves the gradual linking and integrating of previously autonomous affiliates through a series of particular phases, each representing practical tactical responses to then existing external and internal challenges and opportunities.\textsuperscript{166}

The main characteristics of horizontally structured MNEs are these\textsuperscript{167}; first, the enterprise consists of many centres as a result of shifting geographically the focus of control from headquarters to subsidiary level. Second, subsidiaries are granted global or regional responsibilities for a particular function, or product line, or even whole business divisions. Such multi-centeredness as opposed to the view of having one centre and the boundary is a major element in the new model. Third, the importance of culture control is stressed and, fourth, the continuous flow of information across organisational and national boundaries is emphasised.

Accordingly, a less-hierarchical structure comprises the following five dimensions
1- allocation of decision making authority to appropriate levels (mostly to subsidiaries)
2- de-layering of organisational levels
3- geographical dispersion of key functions across

\textsuperscript{165} Bartlett and Ghoshal, Beyond the M-form, (n 125)
\textsuperscript{166} Malnight, The Transition, (n 123)
\textsuperscript{167} Marschan, New Structural Forms, p.5 (n 140)
units in different countries: 4. de-bureaucratisation of formal procedures and 5. differentiations of work responsibility and authority among subsidiary units.\textsuperscript{168}

In this modern form different dimensions are focused upon in a more flexible way. different for different parts of the company and different over time. The organisation encourages managers to think in many dimensions, rather than imposing formalised matrix structures.\textsuperscript{169} This is the dominant characteristic of these MNE forms, referred to as less-hierarchical structures in the present study; they operate as integrated networks: rather than behaving as hierarchical control mechanism.\textsuperscript{170} Accordingly, this new innovative structuring has led to more globalised MNEs placing less reliance on traditional hierarchical governance structures and dictating relationships, and moving towards a system of cross networks based on multiple centres of heterarchical decision taking.\textsuperscript{171} Accordingly, the roles of subsidiaries are getting more important, subsidiaries are given roles as "global innovators" and incorporated players.\textsuperscript{172}

This new form decentralises responsibilities for short-term profit and long-term developments to front-level units who combine with flexibility over the boundaries of divisions to satisfy demands, business relations and customers. Management at top-and middle levels supports co-operation, distribute specialised roles and involve in centralisation. The new model is grounded in a managerial perspective that is very different from that of existing economic and behavioural theories of the firm. Thus, the new organisation in MNEs also challenges management roles, implying that, rather than traditional top-down decision-making; decisions should be made through

\textsuperscript{168} Marschan Rebecca, 'Dimensions of Less-Hierarchical Structures in Multinationals' in Bjorkman I and Forsgren M (eds.), The Nature Of the Transnational Firm (Mumkgaard, Copenhagen 1997) p. 441

\textsuperscript{169} Ghoshal and Barlett, The Individualized Corporation, (n 162)

\textsuperscript{170} Forsgren, Holm and Thilenius, Network Infusion, (n 153) and Hedlund and Ridderstrahle, Towards a Theory, (n 158)

\textsuperscript{171} Dunning, Multinational...Global Economy p.216 (n 9)

\textsuperscript{172} Anderson JC, Hakansson H and Johanson J, 'Dyadic Business Relationships Within a Business Network' (1994) 4 Journal of Marketing 1
communication and collaboration between managers at different levels within different roles.\textsuperscript{173}

Figure 3: the Horizontal Organisation\textsuperscript{174}

There should be no confusion: horizontal exchanges of information and other elements do not exclude headquarters, but it does not necessarily permit headquarters to have a dominant position in decision-making.\textsuperscript{175} In practice, the process of moving toward a less-hierarchical structure is most commonly imposed from the top of the corporation through an essentially centralised effort.\textsuperscript{176} Thus, the fact of the removal of hierarchy does not refer to complete removal of hierarchy. In contrast to the traditional

\textsuperscript{173} Ghoshal S and Barlett CA, 'The Multinational Corporations as an Inter Organizational Network' 1990, 15 Academy of Management Review 603


\textsuperscript{175} White and Poynter, Organising for World-Wide, (n 152) and Marschan, New Structural Forms, p. 3 (n 140)

\textsuperscript{176} Marschan, New Structural Forms, p. 1 (n 140)
hierarchical perspective, in which the centre controls all of the MNE’s activities and makes all strategic decisions, the horizontal perspective assumes multiple centres of expertise around the world, greater strategic rules for subsidiaries, and flexible governance structures.  

The first important case study was conducted by Bartlett and Ghoshal on ABB. On ABB the middle managers’ crucial horizontal linkage role is supported by a top management that creates a value based perspective to support and reward collaborative behaviour, and by a front line management that exploits the personal networks such horizontal relationships facilitate. It is very different process than the vertical planning and resource allocation process at the core classical model, but a vital one for a company competing in an increasingly knowledge-based economy.

Citibank’s European corporate banking structure in 1994 closely resembled network-based MNE models described in the literature. The bank’s structure incorporated centralised products and functional support centres- centres of excellence. Widespread direct horizontal flows between these units and local marketing units were similar to projections by scholars. However, moving beyond this structure, research at Citibank could be used to develop a framework for the transition process in moving from decentralised toward network-based MNE organisational models. For the better understanding of the structure we should examine the structure of Philips as another example.

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178 ABB is a Switzerland based engineering company that operates around 100 countries and employs 108,000 people. Its total asset in 2006 is over $25bn. More information is at [http://www.abb.com](http://www.abb.com)

179 Bartlett and Ghoshal, Beyond the M-form, (n 125)

180 Citibank is a US based financial group and it is the leader in the world in banking sector. More information is at [www.citibank.com](http://www.citibank.com)

181 Malnight, The Transition, (n 123)

182 Malnight, The Transition, (n 123)

183 Royal Philips Electronics of the Netherlands is one of the biggest MNEs in electronics industry. Philips employs 121,700 people in more than 60 countries. More information is at [www.philips.com](http://www.philips.com)
Figure 4: Organizational structure of N.V. Philips\textsuperscript{184}

- Independent Companies
- Managerial Relationships

\textsuperscript{184} Adopted from Ghoshal S and Barlett CA, 'The Multinational Corporations as an Inter Organizational Network' (1990) 15 Academy of Management Review 603
In the chart, it is seen that Philips has subsidiaries in multiple countries and each has managerial ties with the centre in Holland. Moreover, there are regional centres and these centres as well have ties with subsidiaries in the region. More interesting findings in the chart are that regional centres have managerial ties with each other. This proves decentralized nature of the management structure of the group. Moreover, regional centres can make independent decisions from the centre in Holland.

The structure of Shell can be given as another example the simple chart in their website indicates that there is an advice and service relationship between service companies and operation companies. The operation companies have restricted relationship with parent companies since they get these services from the service companies although there is no ownership relationship between those companies. The chart is also indication of power share between parent and subsidiaries.
There is an interesting similarity between the structure of Shell and the structure of Bayer. Similar to Shell, Bayer divides its main organisational structure into three business operations companies and three central service companies. The main function of service companies is to develop better services for the groups' business operating companies. Bayer has also a corporate centre whose function is not clearly stated in their website but from the structure of group, it can be claimed that it does not have a function.

Shell is a global group of energy and petrochemical companies, operating in more than 141 countries and territories, employing approximately 109,000 people. More information is at [www.shell.com](http://www.shell.com).
like a parent companies function in vertical organization. Rather its function is to create
group principles that are applicable in operation of entities under the group.

Figure 6: the structure of Bayer

![Diagram of Bayer's Group Management Board structure]

The conceptual difference between traditional and less hierarchical organisations
is that traditional organisations are characterised by strong reliance on hierarchy and
formal structure. In contrast, less-hierarchical organisations are seen as not being
constrained by formal organisational charts. Rather, these forms of organisation rely
increasingly on informal control and co-ordination mechanisms such as personal
relationships and organisational culture to manage the dispersed subsidiary network. The reduced degree of hierarchy reflects the increased influence of subsidiary units in
relation to headquarters. Horizontally structured MNE models have been associated
with escalating horizontal linkages between scattered operating units through a

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186 Bayer is a Germany-based pharmaceutical company. It operates worldwide through 350 subsidiaries and

187 Ghoshal and Barlett. The Multinational Corporations. (n 184)

188 Forsgren, Holm and Thilenius, Network Infusion, (n 153)
collection of organisational mechanisms, whereas, the earlier enterprises tented to
emphasise a formal organisational structures and their hierarchical operating
mechanism.\textsuperscript{189} Moreover, the evolutionary structure developed in this study presents the
direction of change being driven by steady adjustments in several aspects of operations
of MNEs. Rather than intentionally moving toward horizontal structure, each stage
represented a practical strategic response to then-existing challenges and
opportunities.\textsuperscript{190} Therefore, some enterprises have completed their organisational
evolutions while some others have just started their process. We should also bear in
mind that there is a dynamic changing process in any particular business enterprise.
Therefore, it is important to acknowledge the fact that MNEs are dynamic organisation
with constant changing process, rather than static organisational structure.

Regionally Organised Multinational Enterprises

Another way of operating MNEs is to divide an enterprise into area divisions, each
responsible for all operations in some overseas region. This solution is popular where
the foreign subsidiaries supply one another with components or intermediate products.
However, this requires close coordination.\textsuperscript{191} Subsidiary units are granted highly
specialised roles in terms of functional and geographical responsibilities. In order to
support the new structure several companies have also created finance centres and
regional research and development units to support activities of other subsidiaries. Such
a development trend shows the importance of global functional management and the
need for the new structure.\textsuperscript{192}

\textsuperscript{189} Malnight, The Transition, (n 123)

\textsuperscript{190} Malnight, The Transition, (n 123)

\textsuperscript{191} Caves, Multinational...Economic Analyses p.65 (n 12)
Figure 7: The Regionally Divided Horizontal Organisation

The Parent Company

Ownerhsip relations

Advice and services

Managerial relationships

Local subsidiaries

Marschan, New Structural Forms, p.22 (n 140)
What has happened, particularly within the EU, is that an MNE has transferred an organisational system to each group of its affiliates located in a particular region. The possible gains from internalised transactions between parents and subsidiaries were not sufficient to create the most efficient organisations, thus MNEs prefer regional horizontal structure in order to benefit from common governance of the value-added activities of affiliates.\textsuperscript{193} Thus, we cannot exclude relationships between sister units in regional organisation from the horizontally structured MNEs. Although there may be differences in what actors and relational magnitude influence the internal and the external parts of the organisation, the subsidiary relations in an organisational context should be regarded as another system independent of the legal borders of the MNEs.\textsuperscript{194}

Managing On Global Concern; Common Group Policy

The horizontal structure mostly happens in internal relationship of companies and is very hard to display from outside. MNEs are reluctant to disclose their detailed data of organizational structure. Rather, they prefer giving general information about the group as whole without any particular reference to their structure. However, examining their annual financial and CSR report reveal some indications that they are operating in complex structure and the corporate centre is more policy determinant than direct controller of the subsidiaries.

For example, HSBC\textsuperscript{195} emphasizes the global characteristic of the organisation in their introduction to the group in their website.

"References to HSBC on this website refer to the HSBC Group of discrete legal entities, each of which is wholly or partly owned by HSBC Holdings plc. The entities,  

\textsuperscript{193} Dunning, \textit{Multinational...Global Economy} p.130 (n 5)  
\textsuperscript{194} Forsgren, Holm and Thilenius, Network Infusion, p. 477 (n 153)  
\textsuperscript{195} HSBC Holdings is a public limited company incorporated in England and Wales. The HSBC group operates in five regions. HSBC's international network comprises around 10,000 offices in 82 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. HSBC
which form the HSBC GROUP, provide a comprehensive range of financial services to personal, commercial, corporate, institutional and investment, and private banking clients. To more easily promote the Group as a whole, HSBC was established as a uniform, international brand name in 1999. In 2002, HSBC launched a campaign to differentiate its brand from those of its competitors by describing the unique characteristics which distinguish HSBC, summarized by the words 'The world's local bank'.

The important proposal can be derived from this introduction will be their natural acceptance of operating as a group and promoting this fact by creating an image at global level even though HSBC is consisted of tens of legally independent companies incorporated in different parts of the world. Similar introduction and emphasis can be found in Shell’s website. In their annual review they give brief explanation about what the group is consisted of and how they publicise their group.

"In this Review “Group” is defined as Royal Dutch Shell together with all of its consolidated subsidiaries. The expressions “Shell”, “Group”, “Shell Group” and “Royal Dutch Shell” are sometimes used for convenience where references are made to the Group or Group companies in general. Likewise, the words “we”, “us” and “our” are also used to refer to Group companies in general or to those who work for them. These expressions are also used where no useful purpose is served by identifying the particular company or companies. The expression “Group companies” as used in this Review refers to companies in which Royal Dutch Shell either directly or indirectly has control, by having either a majority of the voting rights or the right to exercise a controlling influence. The companies in which the Group has significant influence but not control are referred to as “associated companies” or “associates” and companies in which the Group has joint control are referred to as “jointly controlled entities”. In this Review, associates and jointly controlled entities are also referred to as “equity accounted investments”. The term “Group interest” is used for convenience to indicate

Holdings plc is held by nearly 200,000 shareholders in some 100 countries and territories. More information is available at www.hsbc.com.

196 Available at www.hsbc.com
the direct and/or indirect equity interest held by the Group in a venture, partnership or company (i.e., after exclusion of all third-party interests)."  

The selection of an MNE and examining its Corporate Social Responsibility Reports (CSRs) indicate similar facts about the argument about the integrated managerial structure. As common theme in their CSR report MNEs are happy to create a report covering all entities in the group. Therefore, it can be considered that having unified CSR is a reflection of modern structure. For example the CSR report of GM takes a global approach.

"GM Corporate Responsibility reporting continues to evolve in order to present a global picture of its business. All specific regional and country/local activity can be found in the web report according to business unit structure: GMNA (US, Canada, Mexico), GME (Europe, UK, Sweden, etc.) GMAP (Asia Pacific Rim, including China, India and Australia) GMLAAM (Latin America, Africa and the Middle East)...The report is global in scope and highlights our key performance indicators for reporting year 2004/5."

Accordingly, in business theory MNEs operate in accordance with common group policy together with global management structure. They create an image as a group and try to promote this image. Therefore, they are eager to use the terms of either brand name like Shell or HSBC or plural forms of expressing the corporate groups such as "we, our group, us". Moreover, the groups include not only wholly owned subsidiaries but also controlled entities as well as associated entities. In short, MNEs operate as integrated groups and create a public image by promoting their enterprise as an integrated group with a group management board and global management structure and common group policy.

197 Available at www.shell.com
198 General Motors Corp. is the world's largest automaker. GM employs 280,000 people and manufactures its cars and trucks in 33 countries. More information is at www.gm.com.
199 Available at http://www.gm.com/company/gmability/
Relationships between the Firms under Different Ownership (Networked Enterprises)

In some cases of multinational business transactions, decisions are not taken by only the firm but originate from the different firms that are connected to each other by contract rather than ownership. This leads to claims that MNEs definitions can be extended to include not only subsidiaries under common ownership and control but also networked companies that are connected to each other in some kinds of contractual and strategic relationship. The basic structure of networked enterprises is examined here because they have shown that many relationship between firms and the network are both heterarchical and multi-dimensional and are similar to horizontally structure MNEs.200

Especially in the last two decades, inter firm agreements have become an increasingly important form of cross border economic involvement. The increasing speed of technological complexity and the need for firms to respond ever more quickly to the actions of competitors have forced them to collaborate to maintain or advance their competitive position.201 Moreover, even the global integration of markets by a single enterprise, particularly in some industries, may no longer be sufficient to balance the huge costs and risks of technological development in a number of strategic industries. Thus, there is a big increase in the number of technology-driven collaborative agreements or strategic alliances among leading MNEs from the major industrial countries; even the largest MNEs must cooperate to deal with the cost, risk, and complexity of technology.202 Alliances represent a transformation of the mode of organisation of international economic transactions from hierarchically structured MNEs to networked companies.203

200 Dunning, Multinational...Global Economy p.258 (n 5)
201 Kobrin, The Architecture of Globalisation, p. 151 (n 85)
202 Kobrin, The Architecture of Globalisation, p. 151 (n 85)
203 Kobrin, The Architecture of Globalisation, p. 151 (n 85)
Whereas most of the analysis of cooperative alliances has centred on the relationship between different groups but in international relationships, it is clear that modern MNEs are adopting a more pluralistic approach to their overseas activities. Consequently, the form and structure of these networked groups will influence the model of the relationships between the firms under collaboration. A network relationship implies that there are some linked transactions of firms within the network. There is a well-structured division of work amongst firms in the network. In short, the activities are coordinated neither by the market nor by a central hierarchical plan but by the establishment of a set of relationships between the members of the network. As a result, these newly established relations create the network.

It is a fact that cooperative alliances, reshaping of the boundaries of firms, brought about by the growth of inter-firm collaborative agreements opens up new challenges to the researchers. However, these strategic alliances represent a networked model of organisation of international economic transactions, which can be distinguished from MNEs, which have different aims in their structure strategies. The aim of networked organisations is to reach a completion of a particular business project determined by a contract by participating organisations and usually limited by time. The relationship amongst the units in the network is limited by this aim and thus is not very widespread or complicated as in horizontal structure. Therefore, it is very unlikely to see similar control mechanism and intense exchange of staff and components and less financial assistants amongst the units in networked organizations. Accordingly, one central question is relevant here whether networked company organisation is separate organisational types employing distinctive control mechanisms or plural forms on the governance of multinational commercial transactions. We can conclude that although networks are a distinctive form of economic organisation, they do not represent the same characteristics as horizontally structured MNEs since there is no ownership relation

204 Dunning, *Multinational…Global Economy* p.92 (n 5)
205 Dunning, *Multinational…Global Economy* p.92 (n 5)
206 Dunning, *Multinational…Global Economy* p.92 (n 5)
207 Kobrin, *The Architecture of Globalisation*, p. 151 (n 85)
amongst the firms. Therefore, networks represent a type of arrangement with its own specific distinctive features, which hereafter must be considered separately.\textsuperscript{208} As a result, as Professor Dunning points out, since they address somewhat different issues, it is unlikely that the network model of internalisation will replace that of the structure under MNEs model.\textsuperscript{209}

At this stage, it is necessary to mention other inter-firms agreements. The most popular inter-firm agreement is joint ventures, which can be defined as a legal entity formed between two or more parties to undertake economic activity together. However, joint ventures represent one type of inter-firm agreement and this currently extends to networked or other more complex relationships. Some of the joint venture contracts are vertical contracts: technology-transfer agreements, franchise contracts and input-supply agreements. Some other relations are more heterarchical in these types of organisations. For the same reasons articulated under the networked companies, the main characteristics of the joint ventures are the same as networked company structures; joint ventures do not fall under the examination of this study in order to allow comparison of the networks of subsidiaries under a MNE group.\textsuperscript{210}

**Evaluation of Organisational and Managerial Structure of MNEs**

All these evaluations of the MNE structures of organisation show that the relationship between parent companies and national subsidiaries in an MNE are not identical to those among an interacting group of universities, or social service organisations or state regulatory bodies or international political and economic institutions.\textsuperscript{211} MNEs distinguish themselves in their goals, which are maximising the profits for their shareholders. Thus, MNEs have undergone changes in order to adapt themselves to

\textsuperscript{208} Kobrin, The Architecture of Globalisation, p. 152 (n 85)

\textsuperscript{209} Dunning, Multinational...Global Economy p.208 (n 5)

\textsuperscript{210} Marschan, New Structural Forms, p. 4 (n 140)
dynamics of the new world affected by globalisation. MNEs responded to the challenges (If we cannot say they created the challenges) first between the social and business organisation and adopted new organisational and management structures. In particular, the new structures of MNE images are used to describe the emerging world economy: a shift from standardised mass production to flexible production, from vertically integrated, large scale organisations to unification of the value chain and horizontally networked economic units.

In the business world, the structure of this organisation is invisible from the position of any particular organisation, and it has no legal status. It is, nevertheless, a significantly important non-contractual aspect in setting the outline of limitation under which the structures of enterprises must operate. Since it is a fact, the law must recognise these facts and should create essential regulatory frame for operation of these institutions.

The system showed its effect on the governance of the organisation splitting the responsibilities between the managers on different levels. The new management structures are fundamentally different than the ones that were dominantly used in the past by multinationals. The new structure shows its effect not only in management systems but also in the structure of subsidiary ownership since it has to create a suitable legal background for the new managerial system to operate. The reason for creating legally independent companies was to meet the needs that the M-form created because the M-form created semi-autonomous units in the enterprise. This autonomist management structure could be achieved best by crating legally independent units. Moreover, the hierarchical characteristic of the M-form led to a simple legal structure; mostly fully owned subsidiaries and sub-subsidiaries with little cross-ownership.

211 Ghoshal and Barlett, The Multinational Corporations, (n 184)
212 Dunning, Multinational ... Global Economy p.218 (n 5)
213 Kobrin, The Architecture of Globalisation, p. 154 (n 85)
The horizontal organisation requires, on the other hand, more complex ownership structures for MNEs. This leads MNEs to consider ownership structures under the group since the risk and management is divided. Therefore in horizontal structures it is very likely that we will see very complicated structures of cross-ownership between the companies under the group. HSBC can be given as a very simple example for this. On their website they have published a very simplified scheme of their group ownership structure. According to the HSBC Group Structure of Principal Operating Companies at January 2004, HSBC Holding Place is the main company, in the lower levels; the more we go to a lower level the more cross-ownership we see. The subsidiary companies have shares for other subsidiaries ranking from 3% to 100% percent. And this chart is only simplified ownership structure; many of the lower units have been excluded.215

Figure 8: The HSBC Group Structure of Principal Operating Companies at January 2004

- Boxes indicate the independent companies within the HSBC group. Percentage figures in the boxes indicate ultimate percentage owned of that company within the HSBC Group.
Consequently, cross-ownership is a fact rather than an exception in MNEs structures. The reason for cross-ownership is the need to create appropriate legal flexibility for horizontal managerial structures. Thus, the new regulations should consider the cross-ownership together with horizontal managerial structure to regulate MNEs. Thus, the legal flexibility that limited liability of companies creates has been used to organise this flexible structure.

In conclusion, the new organisational structure emphasises two important characteristics of MNEs, which are very important for conducting the discussions made in this thesis. The first one is the emphasis on horizontal structure with complex ownership structure and geographical dispersal of subsidiaries at global level. Second important characteristic is the replacement of hierarchical control with more flat cultural control.

The Legal Environment for Multinational Enterprises

Historically, both in civil and common law systems, company laws are based on the concept of separate legal personality. It is assumed that a company is a distinct economic unit, which enjoys economic and managerial independence, and therefore, must be considered as a legal person separate from its members. Legal personality gives great flexibility to an organisation in structuring its affairs and facilitates creative exploitation of property rights. It also gives representative rights; they can sue and be sued, represent themselves in a court and can undertake obligations independent from its shareholders. Consequently, the English American and even new emerging European Community Company Law are still based on the independence of companies. The independence theory covers all companies, including single man companies and wholly owned subsidiaries of MNEs.
On the other hand, companies are creatures of national legal systems since they are incorporated in certain states. They are tied to certain nationalities from different perspectives as well.\footnote{Domiciles and jurisdiction over companies are discussed at chapter 2 in detail.} However, in transnational economic activities, a single and independent national company exists only in theory. Since the emergence of modern company laws in the second half of 19th century, there have been speeches, teachings, litigation and legislation about company law but the primary reality today is not only the company, it is also company groups that have dominated the business world.\footnote{Nolan A, ‘The Position Of Unsecured Creditors Of Corporate Groups; Towards A Group Responsibility Solution Which Gives Fairness And Equity A Role’ (1993) 11 CSLJ 461} Even small-scale economic activities might be structured to operate their business under a corporate group structure. The domination of corporate groups can apparently be seen in case of cross-border business operations since the largest commercial and industrial enterprises of the world are typically organised as groups of companies. They have tens of subsidiaries scattered around the world and some of the MNEs are bigger than national state economies. However, the legal status is still in a state of uncertainty since it depends on theories that are mainly based on a single private company. Thus, although, the group structured MNEs have symbolised the efficient modern business actor ever since its emergence this new affiliated enterprise system has been viewed as a special problem for the balance between the majority and minority shareholders in the corporation, and as a potential danger for the creditors of a subsidiary.\footnote{Lutter M, ‘Enterprise Law Corp. vs. Entity Law Inc. - Philip Blumberg's Book from the Point of View of an European Lawyer.’ (1990) 38 American Journal of Comparative Law 949}

Groups of companies may, economically, be defined as a union of companies, which operate under an aim to ensure the profitability of the association as a whole.\footnote{Avgitidis Dimitris K., Group of Companies; The Liability of Parent Company for the Depths of Its Subsidiary (Sakkoulas, Athens-Komotini 1996) p. 71} Some common characteristics of the group enterprises are these; first, a typical group of companies constitutes an economic unit, which is divided into a great number of legal units, for purposes of exploiting any possible convenience and benefit. Second, a different and simpler functional group structure is applied in the complex legal structure
of the group. For more formal and general purposes, the OECD Guidelines for Multinational Enterprises provides the widest and the most accepted definition of MNEs in the international area; "multinational enterprises usually comprise companies or other entities established in more than one country and so linked that they may coordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another, ownership may be private, state or mixed". 220

Accordingly, the characteristics of MNEs are these; firstly, they must be organised as more than one company, in a way so that each and every company has its own legal personality, assuring that a subsidiary can have legal relations of its own, both within the organisation and with outsiders. 221 Secondly, these companies must be related to each other through ownership and/or control and must operate as a commercial enterprise. Thirdly, the subsidiaries must perform in other countries rather than home counties. According to these criteria, an MNE can be, in a practical approach, defined as group of companies that through foreign direct investment organise subsidiaries under common ownership and management policy in a number of countries outside its home base.

The most outstanding feature of multinational company groups is their incredible complexity. 222 An MNE can have hundreds of subsidiaries all around the world and each subsidiary operate under its host country’s regulatory arrangement, but practically they operate in accordance with the main economic and managerial policies of the group. Therefore, there is a compound multinational enterprise structure under which, according to law, companies are independent from each other, but, on the other hand, according to economic realities, they are completely interrelated. Thus, even in a group of companies it is sometimes difficult to distinguish between the legal personality of one

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220 OECD Guidelines for Multinational Enterprises, 27 June 2000 p.18
221 Griffiths Andrew, Corporate Governance And The Uses Of Company (University of Manchester, 1993)
member corporation and its wholly owned and controlled subsidiaries.\textsuperscript{223} This complicated corporate structure is the main characteristic of both in Civil law and the Common law systems, which may be the most important common statement for the area of corporate affiliated enterprise system.\textsuperscript{224}

The attraction of a subsidiary is that the combination of legal personality and limited liability enables its controller to separate an area of activity, or particular assets, and to control the subsidiary's legal relationship with the wider organisation because the law has given little recognition to the essential differences between subsidiaries and freestanding companies. There is an effective shifting of risk from the controllers and owners to the creditors of a subsidiary resulting from its limited liability.\textsuperscript{225} Therefore, the tendency in the UK as in the United States is for holding companies, other than pure investment companies to hold 100 percent of the shares in all their subsidiaries.\textsuperscript{226}

This control of shares by another company is not only control but also brings subsidiaries under common group management systems. Here the problems arise, as unlike the individual majority shareholders; the common management system may have a reason to direct the subsidiary to act contrary to its own interest and may even put its existence in danger. Therefore, being controlled and managed by a company shareholder and especially being open to be interfered with by other companies under a group structure could put corporate creditors at risk.

As a result, modern enterprises largely comprise groups of corporations under common ownership and managerial structure. They present the possibility of dividing an enterprise into smaller incorporated units to perform particular functions. The reasons for separate incorporations may range across a broad variety such as sheltering other units of the enterprise from subsidiary liability in specialised financial transactions and

\textsuperscript{223} Nolan, The Position, (n 217)
\textsuperscript{224} Lutter, Enterprise Law Corp, (n 218)
\textsuperscript{225} Girffiths, Corporate Governance, (n 221)
evading possible tort liability. Thus, there can be use of corporateness to clearly further legitimate goals or possible abuse of corporate structure to avoid social conflict and corporate liability.\textsuperscript{227} The main causes of the current problems in MNE concepts find their roots in two historical developments in the times of the emergence of capitalism and then big companies in the second half 19\textsuperscript{th} century. The first one is limited liability and the other one is allowing companies to have shares of another company. I want to examine the second development first in order to reach a better understanding of the problems that limited liability of companies brought.

\textbf{Emergence of Multinational Enterprises}

In the early days, in America, the major restriction on corporate power- the lack of authority to acquire stock – was firmly established. Even some states, i.e. New York and Illinois, went further and enacted statutes, expressly prohibiting corporations from acquiring and holding stock in another corporation.\textsuperscript{228} As a result, authorization for the ownership of shares of other corporations was very reluctantly granted and only to companies of a public character, such as railroad companies. In the absence of an express provision in the statute or the charter, it was held \textit{ultra vires} or unlawful for a corporation to acquire shares in another corporation.\textsuperscript{229} However, this rule was changed dramatically after the acceptance of removing all restrictions and expressly authorising businesses incorporated in New Jersey to acquire the stock of "any other company that the directors might deem necessary".\textsuperscript{230} After New Jersey, other states followed and

\textsuperscript{227} Cashel Thomas W, ‘Multinational Challenge To Corporation Law: The Search For A New Corporate Personality (Publication Review)’ (1994) 9 JIBL 249

\textsuperscript{228} Blumberg PI, The Multinational Challenge to Corporation Law (OUP, Oxford 1993) p. 54

\textsuperscript{229} Avgitidis, Group of Companies p. 69 (n 219) and Blumberg PI The Law Of Corporate Groups: Tort, Contract, And Other Common Law Problems In The Substantive Law Of Parent And Subsidiary Corporations (Little Brown & Co, Boston, 1987) p. 56-60

\textsuperscript{230} Blumberg, The Multinational Challenge p. 56 (n 228)
eventually, the authority of corporations to own the shares of another corporation became universally recognised.\textsuperscript{231}

The first signs appeared in the railroads, whose exclusive operations led to the development of systems of bordering roads connecting important centres. Such provisions also appeared in charters of other railroads, bridge, steamship, and canal companies, but rarely appeared in the case of manufacturing companies.\textsuperscript{232} Railroads thus comprised the first corporate groups in the country. Subsequently, the group structure has emerged as a usual business organisational structure and manufacturing companies followed the public sector companies and turned to be structured as a trust, similar to public trusts, like oil and sugar.

In 1890, the New York courts held the Sugar Trust to be unlawful, and 1892, the Ohio courts outlawed the Oil Trust.\textsuperscript{233} The Sherman Antitrust Act was adopted in 1890. It became plain that trust could no longer serve a mechanism for industry. Following the new legal situation, anxious corporate counsel recognised that the power to acquire shares of competitive corporations, if available, would serve as an alternative route to gain centralised control of competing firms and achieve market concentration, perhaps even avoiding the Sherman Act.\textsuperscript{234} New Jersey – enthusiastic about enriching its treasury with license fees from corporate promoters- enacted its pioneering statutes in 1888, 1889, and 1893. These new statutes provided an alternative route to industrial grouping, replacing the trust device that was then being outlawed.\textsuperscript{235} The new law was the turning point for American business because a corporation no longer represented the whole enterprise; the enterprise became increasingly segregated between parent and subsidiary corporations. In contrast to the simple corporation with its clear line of distinction between the enterprise conducted by the corporation and the investors represented by the

\textsuperscript{231} Blumberg, \textit{The Law... Tort, Contract} p. 59 (n 229)

\textsuperscript{232} Blumberg, \textit{The Law... Tort, Contract} p. 57 (n 229)

\textsuperscript{233} People \textit{v. North River Sugar Refining Co.}, 121 N.Y. 582, (1890), \textit{State ex rel. v. Standard Oil Co.}, 49 Ohio St. 137 (1892)

\textsuperscript{234} Blumberg, \textit{The Multinational Challenge} p. 56 (n 228)

\textsuperscript{235} Blumberg, \textit{The Multinational Challenge} p. 56 (n 228)
shareholders, the corporate group was rather different; the parent and shareholders combined made up the enterprise.

In Britain, a company was able to purchase shares in another company only by virtue of a provision to this effect in the memorandum of association of the purchasing company. The 1862 English Companies Act provided for incorporation via the registration of companies: under this system, the company powers were specified not only in the statute, but also in the company's memorandum of association. In England therefore, corporate power to acquire and own the shares of another corporation could arise from provisions inserted in the memorandum by the promoters and their counsel, notwithstanding the omission of such power in the incorporation statute. Where the memorandum of association was silent, the English court held that it was ultra vires for a company to purchase shares of another company. In *re Bamed's Banking Co.* and in *re Asiatic Banking Corp* it was held the power existed and neither the common-law nor the 1862 Act invalidated the provision in the memorandum of association. With this case pointing the way, the power to acquire and own shares of another corporation was thereafter simply achieved by drafting the memorandum of association accordingly.

In summary, groups of corporations first developed more than 100 years ago, and met weak resistance from courts and in scholarly literature because they were not on the international level but rather mainly in the USA, and performing predominately in big business industries. However, with the use of this right as main strategy to perform business, the group of companies became the basic company type in the developed industries. At this point it must be stressed that at the time when limited liability was established, groups of companies were virtually unknown.

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236 Blumberg, *The Law... Tort, Contract* p. 61 (n 229)

237 *Re Bamed's Banking Co., ex Parte Contract Corporation* (1867) LR 3 Ch App 105, *Re Asiatic Banking Corp* (1869) 4 LR-Ch 252 and *Great Eastern Railway v. Turner* (1872) LR 8 Ch App 149

238 Blumberg, *The Law... Tort, Contract* p. 61 (n 229)

239 Lutter, *Enterprise Law Corp* (n 218)

240 Avgitidis, *Group of Companies* p. 69 (n 219)
Limited Liability; Definition of the Concept and Historical Development

The economic and legal history of company law depends on the nameless inventors of the principle of limited liability, as applied to trading corporations that were pioneers of the Industrial Revolution. The cleverness of these men produced the principle by which the productivity and power of modern companies reached its top. In 1911 the president of Columbia University moved to claim that: "I weigh my words when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times.... even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative importance without it."241

Limited liability, under the Companies Act, means that shareholders have no obligations to the company or its creditors beyond their obligations on the par value of their shares, or under their guarantee in the case of a company limited by guarantee.242 Limited liability restricts shareholders’ liability to the company to the amount of money they invest, which means that in case of insolvency and under payment to creditors, shareholders cannot be made to pay more than they invest. Under this traditional corporate rule, a subsidiary corporation’s liability is also limited to the amount of its shareholders’ investment, and the parent or any other company under the group cannot


242 Farrar John H, Company Law (Butterworths, London 1998) p. 82, He defines limited liability as “it (limited liability) is a fundamental principle of corporate law that shareholders in a corporation are not liable for the obligations of the enterprise beyond the capital that they contribute in exchange for their shares". Thompson Robert B, 'Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise' (1994) 47 Vand. L. Rev. 1 defines “Limited liability is a presumptive of law that facilitates the development of public markets for securities, permits the allocation of risk or benefits between parties and supports the certainty of planning by those who have organised the corporation.” Farmer Richard S, 'Parent Corporation Responsibility For The Environmental Liabilities Of The Subsidiary: A Search For The Appropriate Standard' (1994) 19 Journal Of Corporation Law 770 gives another definition as that “Limited liability means that the investing shareholder is liable for the debts of the corporation only to the extent of its original investment in the entity, the stock purchase money".
be held liable for the subsidiary’s non-performed obligations.\textsuperscript{243} However, concepts should not be confused; it is not the company that enjoys limited liability, it is the shareholders of the company whose liability is limited.\textsuperscript{244} The company, as a legal person, is liable for its torts and obligations arising from any source but the limited liability theory is applied in case company’s assets are not enough to meet the obligations.

Limited liability was an entirely innovative doctrine, which was devised as a result of the pressures put on growing corporations during the first half of the 19\textsuperscript{th} century to raise the capital required to take advantage of the emerging technology of the times.\textsuperscript{245} Accordingly, in the UK, the Limited Liability Act 1855 was quickly replaced by the Joint Stock Companies Act 1856 which was this Act that introduced the rule into English law that such companies would have to add, ‘Limited’ or ‘Ltd’ to their name.

In the beginning, companies aimed to collect money from individuals since in the early corporate history acquiring shares of another corporation was not approved by the courts.\textsuperscript{246} However, this rule changed dramatically after the acceptance of dropping all restrictions on acquiring shares in another company. This means that limited liability had become the established rule long before corporate subsidiaries, basically group of companies, were common or even, in general, legal. The new stage then, with the emergence of corporate groups, is the discussion of the question of whether limited liability protects the component companies of the new corporate groups in addition to the investors in the enterprise. To be able to answer this question the separate personality of companies from its shareholder must be clarified under the examination of two

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\textsuperscript{244} Magaisa Alex, ‘Corporate Groups and Victims of Corporate Torts - Towards a new Architecture of Corporate Law in a Dynamic Marketplace Law, 2002 (1) Social Justice &Global Development Journal 1

\textsuperscript{245} Hansmann Henry and Kraakman Reiner, ‘Toward Unlimited Shareholder Liability for Corporate Torts’ (1990-1991) 100 Yale L.J. 1879

\textsuperscript{246} Blumberg, The Multinational Challenge p. 54 (n 228)
famous cases, which are *Salomon v Salomon & co ltd* 247 and *Lee v Lee’s Air Farming Ltd.* 248

The facts of the *Salomon* case were as follows; Mr. Salomon created a company whose shareholders were himself, his wife, his daughter and four of his sons. Mr. Salomon then sold his business to the company and received a further 20,000 shares and a £10,000 debenture from the company as the purchase price. Mr. Salomon then continued to run the business as managing director and, as he also had 20,001 of the 20,007 shares, was very much in control. The company soon encountered financial difficulties, with Mr. Salomon selling his debenture to raise further money for the business, but despite this it was eventually wound up. The assets of the company were sufficient to pay the debenture holder but not the company's unsecured creditors. The liquidator claimed that the company was a scheme designed to defraud creditors and thus that the debenture should be saved, or alternatively that it was merely the alias or agent of Mr. Salomon. These arguments were accepted by the Court of Appeal.

Consequently, in 1897 this issue of limited liability and separate corporate personality were finally settled by the highest judicial body in the United Kingdom; the House of Lords ruled that individuals could organise their affairs, as they wanted and that if they choose to do so via incorporation they were entitled to the protection of limited liability as long as the incorporation was in accordance with the formal rules of the relevant legislation. 249 Thus *Salomon* brought about the situation that incorporators of a company could structure its capital so as to minimise the risk to them of the company’s failure by taking some form of secured debenture; there is no requirement that the investment of the incorporators in a company must necessarily to a significant extent be in the form of equity. 250 Hence, separate legal personality meant just that, and

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247 [1897] AC 22 HL
248 [1961] AC 12 PC
it follows from this that a corporation is separate from its members and as such the later not liable for its debts.251

These decisions on these two cases showed their effect for all corporations including corporate groups. Accordingly, under traditional corporate law each component corporation of the group, whether parent, subsidiary or affiliate, for legal purposes were still separate and distinct from every other corporation in the group, and its rights and responsibilities were divorced from those of the other constituent companies of the group.252 For that reason, although the companies in the group, unlike its public shareholder-investors, were parts of the enterprise and engaged in the daily run of business, limited liability also insulated them from liability for the activities of its subsidiary companies because it was not discussed deeply and the simple logic determined the situation that limited liability protects shareholders, a corporation is a shareholder of the subsidiary, and therefore, limited liability protects the shareholder corporation.253 This situation can shortly be defined as follows; under limited liability the group collects the full reward if the subsidiary is successful, but does not bear the full loss in case of disaster.254 Therefore, limited liability rules are usually acknowledged to create incentives for excessive risk-taking by permitting corporations to avoid the full costs of their activities.255 In statutory developments, there have been several Companies Acts since 1897 and changes to the incorporation formalities have been made; yet no attempt has ever been made to legislate against the rule in Salomon. Some attempts have

251 In Lee v. Lee's Air Farming, The Privacy Council held that Lee, as a separate and distinct entity from the company which he controlled, could be an employee of that company so that Lee's wife could claim workers' compensation following her husband's death. Separateness of personality enabled him to be an employee as the pilot and thus his widow was entitled to compensation under the scheme.

252 Collins Hugh, 'Ascription of Legal Responsibility to Groups in Complex Patterns of Economic Integration' (1990) 53 Modern Law Review 731

253 Collins, Ascription of Legal, (n 252)

254 See Dine Janet, The Governance of Corporate Groups (Cambridge University Press, Cambridge 2000) and Blumberg, The Multinational Challenge (n 228)

been made to avoid or exempt certain areas from the general rule but though with the exception of specific statutory acts, little has been achieved.\textsuperscript{256}

In conclusion, under the economic circumstances of the time when the limited liability doctrine was accepted, economic analysis assumed that a society with greater wealth, measured in terms of profit maximisation, was necessarily better off than a society with less.\textsuperscript{257} Therefore, limited liability permitted parties to allocate the risk of an enterprise to a more efficient risk-bearer in particular circumstances, namely the voluntary or involuntary creditors of corporations.\textsuperscript{258} Nevertheless, the full effects of application of limited liability were not clear at the time of its emergence, or even in recent times because the emergence of limited liability was not an essential characteristic of corporate law. In reality because of the escalation of industrialisation, limited liability finally emerged as a political pressure, not as a usual consequence of the concept of a corporate body. Thus, in England and America, the adoption of limited liability was problematic and followed political debate state by state. It must be stressed that it was only during the first quarter of the twentieth century, a half century after the acceptance of limited liability, that this power was universally recognised.\textsuperscript{259} For example California insisted on unlimited liability companies till almost middle of last century.\textsuperscript{260}

\begin{itemize}
\item \textsuperscript{256} Griffin Stephen, '(Case Comment) Holding Companies and Subsidiaries – The Corporate Veil' (1991) 12 Comp Law 16
\item \textsuperscript{257} Freedman Judith, 'Limited Liability: Large Company Theory and Small Firms' (2000) 63 M.L.R. 317
\item \textsuperscript{258} Thompson Robert B, 'Piercing the Corporate Veil: An Empirical Study' (1990-1991) 76 Cornell L. Rev. 1036
\item \textsuperscript{259} Avgitidis, Group of Companies p. 69 (n 219)
\item \textsuperscript{260} Leebron David W, 'Limited Liability, Tort Victims, and Creditors' (1991) 91 Colum L Rev 1565
\end{itemize}
Reasons for Limited Liability

The origins behind limited liability is to encourage people to invest money in corporations and therefore it has been viewed as an essential element in free market economies; allowing investors to contribute capital to an enterprise without risking their personal wealth.\textsuperscript{261} Thus, the argument of mainstream law and economics analysis in favour of limited liability is based on the use of incorporation to raise capital from outsiders.\textsuperscript{262} Thus, the limited liability was an invention central to the creation of a modern capitalist economy.\textsuperscript{263} The limitation of risk functions as an incentive to investment and, therefore, it is a factor contributing to economic development. There are three main economic functions of limited liability; stimulating investments, minimising cost and shifting risk.\textsuperscript{264}

Stimulating investments is considered as the primary economic function of limited liability. Since shareholders are not liable for more than they invest, it is believed that companies will attract more money for their shares. Accordingly, the most important economic need for the limited liability company is that it encourages investment by absent investors, because investments under a limited liability regime have greater expected value and are less risky to investors than investments under unlimited liability.\textsuperscript{265} It is a fact that limited liability plays an effective role for enterprises even today on the consideration of stimulating investments.

The cost minimising function of limited liability manifests itself in four different ways; first, limited liability reduces the costs involved in the separation between

\begin{itemize}
\item \textsuperscript{262} Freedman, Limited Liability, (n 257)
\item \textsuperscript{263} Easterbrook Frank H and Fischel DR, ‘Limited Liability and the Corporation’ (1985) 52 U. Chi. L. Rev. 89
\item \textsuperscript{264} Easterbrook and Fischel, Limited Liability, (n 263)
\item \textsuperscript{265} Leebron, Limited Liability, (n 260)
\end{itemize}
management and ownership. Second, limited liability reduces the information costs that a shareholder has incurred in order to be constantly aware of the real value of his investments. 266 This creates an advantage in that it decreases the investors’ need to monitor the management of the company because they are responsible for just the amount they invest. 267 Third, limited liability reduces the costs involved in the operation of securities markets. Limited liability relieves a company’s shareholders of the usual risks and responsibilities of ownership and therefore reduces their need to be involved in management or to be more than mere investors. 268 Finally, limited liability reduces the company’s cost of raising capital; it enables a company to be financed on the most favourable terms. From the market economy perspective, since limited liability allows for the free transfer of shares, it promotes market economies and creates a competitive atmosphere for companies while facilitating diversification of portfolios, which is considered very important for development of economies. 269

Easterbrook and Fischel stress the importance of limited liability to the corporate structure; only in such an environment can the critical features of centralised management and investor willingness to bear the risk exist. 270 Limited liability makes investors willing to give management functions to a centralised corporate group and to undertake risky projects. Not only shareholders but also voluntary creditors benefit from these rules. As to involuntary creditors, their loss from limitations on liability is moderated by incentives to provide insurance, which adequately substitutes for the personal liability of shareholders. 271

Therefore, the discussion and problems are collected on the fact that limited liability removes the risk of the company’s failure from shareholders and shifts it to

267 Easterbrook and Fischel, Limited Liability, (n 263)
268 Griffiths, Corporate Governance, (n 221)
269 Freedman, Limited Liability, (n 257)
270 Easterbrook and Fischel, Limited Liability, (n 263)
271 Easterbrook and Fischel, Limited Liability, (n 263)
creditors. On this characteristic of limited liability, there is a conflict between economic principles that are based on the aim of reaching profit maximisation and legal principles that are based on reaching basic justice. The economic theory accepts the injustice for creditors but it claims limited liability creates incentives for society as whole and thus, it is justifiable and must be sustainable. Moreover, the economic theory assumes that creditors can alter the terms by negotiating to the company. However, shifting the risk causes great-unsolved problems in case of mass torts since tort victims involuntarily involve in corporations.\textsuperscript{272} As a result, shifting the risk gives very important incentives for company groups to structure themselves as a group of limited liability entities. Thus, the efficiency of economic analysis for limited liability must be discussed.

**Economic Analysis of Limited Liability**

All supporters of the limited liability company theory have structured their arguments on the hypothesis of the absence of limited liability and they mainly claim that in case of unlimited liability the efficiency of capital markets will be seriously damaged.\textsuperscript{273} Therefore, the standard arguments for limited liability are based on the empirical claim that on balance, corporations create more wealth than they destroy and whereas it is regrettable that third party creditors must sometimes suffer, the benefits outweigh these unfortunately distributed costs.\textsuperscript{274} The argument of creating more wealth for society has turned out to be main problem of the globalised economic world. The calculation of benefits is based on the simple methodology that if economic activities of companies with limited liability create in total more wealth than it loses; following the theory that is good for society. However, this calculation of benefits of limited liability ignores the distribution of the loss, which is mainly loaded onto involuntarily creditors. Therefore,

\textsuperscript{272} The difference between voluntarily and involuntarily creditors is discussed below. (p 115)

the theory must be reconsidered since it is unjustifiable to impose the burden of risk on the weakest.

Supporters of limited liability company theory introduce their arguments against the assumption of unlimited liability for companies under three titles. Firstly, unlimited liability is dangerous for shareholder and capital economies. Secondly, making shareholders unlimitedly liable puts them in danger of being suddenly and unexpectedly thrown into personal bankruptcy and shareholders would have the difficulty of assessing and monitoring companies' management because many shareholders do not have enough knowledge to monitor and evaluate the companies' operations. Consequently it might make shareholder diversification costly or impossible. Another important problem that could arise in the case of unlimited liability is conflicts of law and enforcement problems.275

The most important question in assessing the justification of limited liability is whether limited liability allocates risk to those most capable of bearing it. At the time the limited liability company first appeared the main concern was not fair allocation of risk but the distribution of resources between people according to political and economic criteria.276 However, this seems to be still common defence for limited liability even though business, law and companies themselves have undergone fundamental changes.277

According to the risk shifting argument, in order to determine the most efficient allocation of risk between corporate groups and involuntary creditors, two criteria should be examined; the ability of the parties to avoid risk and their ability to bear the risk. It is obvious that groups of corporations can apparently bear and avoid risks better

275 Alexander, Unlimited Shareholder, (n 273)
277 Presser, Thwarting the Killing, (n 266)
than involuntarily creditors.\textsuperscript{278} Therefore, limited liability does not provide a fair risk allocation between corporate shareholders and creditors, especially in case of immunity of shareholders from liability to involuntary creditors.\textsuperscript{279} This injustice will be severe when we consider of MNEs because of their immense economic power and complex structure. This proves that the economic explanations of limited liability are usually based on the consideration of individual shareholders rather than shareholder companies. Thus, limited liability reflects a desire to help out smaller investors, those more typical of the people, thus reflecting democracy as much as economics. Then, limited liability should be most welcomed for smaller firms who are dependent on individual contributions and not those possessing great economic wealth.\textsuperscript{280} Accordingly, the realities related to economic and business structures of MNEs have proved that it is unfair to sustain the current legal structure. In other words, the conceptual structure of company law has become ever more divorced from the economic and social realities to which it applies and has taken on a life of its own.\textsuperscript{281}

The argument of promoting capital market efficiency via limited liability is not exactly convincing either, because before the adoption of limited liability there was a developed capital market industry in England and in other western countries; for example, California kept its unlimited pro rata liability system until the middle of the 20\textsuperscript{th} century.\textsuperscript{282} There was no evidence that limited liability for corporate groups was making much difference in economic development since MNEs already have the resources to invest in third countries.\textsuperscript{283} Moreover, the MNEs are always given immense incentives by countries to invest in their territory so they are already in good bargaining position. Giving them extra protections, especially through limited liability, is making them untouchable by the law.

\textsuperscript{278} Note, Liability of Parent, (n 255)
\textsuperscript{280} Presser, Thwarting the Killing, (n 266)
The relative monitoring cost for alternative risk bearers’ argument cannot be justified if the alternative bearer is a MNE that can have assets bigger than many less developed countries’ economic power. Experience has already proved that monitoring of another company under a group is part of conducting business, thus it cannot be claimed that if company shareholders are unlimitedly liable, the group will apply detailed and costly monitoring process. Moreover, the disclosure requirements for groups of companies are increasing; MNEs are required to disclose most of their economic and financial relations as a group, which makes the monitoring argument less valid.

The supporters of limited liability explain the fairness of limited liability on the basis that it is swallowing liability rather than shifting it and under unlimited liability regimes creditors may be left uncompensated after the resources of shareholders have been finished. Subsequently, involuntary creditors can mostly find enough compensation in case of tort, if they cannot; it is the unfairness of social life. However, the incidents, like Bhopal, Shell in Nigeria, use of asbestos by Cape Industries, have demonstrated that the damage is not swallowed; it is fiercely felt by the people who are exposed to disaster.

All the ideas in support of limited liability meet at the middle point that despite its difficulties and unfairness, limited liability may be a necessary evil. Consequently, there is an agreement on the need for criticism of limited liability, but also on the fact that unlimited liability is neither a practical nor a theoretically superior alternative to limited liability companies. It can be concluded that limited liability may well be a necessary consequence of trading in modern capital markets rather than an optional rule that can be abandoned by the legal system if some other doctrine seems preferable.

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283 The investment theories for MNEs are discussed above. (p 53)
284 Freedman, Limited Liability, (n 257)
285 Detailed information is at www.bhopal.net
Moreover, the difficulty to find an alternative and the relative importance of limited liability for settled market economies led to the claims that even if limited liability were not introduced by lawmakers or in case of abandonment of it, the business practice could have invented limited liability in the liberal markets through the principles of freedom of contract. This argument has valid points from the perspective of voluntarily creditors since the relationship between voluntarily creditors and companies are established on the basis of mutual consent with the full knowledge of dangers and benefits of limited liability. Thus, in contractual liability, even if unlimited liability is introduced, it is very likely that companies will have clauses that prevent shareholders from unlimitedly liable. However, since the complex and unexpected characteristics of corporate torts, it is not possible to agree with this argument in respect of involuntarily creditors. Thus, companies cannot introduce limited liability for shareholders in tort claims. The argument carried out in the thesis is to establish liability for corporate torts, particularly MNEs liability for subsidiaries’ tort. The nature of corporate tort makes impossible to do some prearrangements with victims to accept limited liability for shareholders. There is a legal impossibility since the parties are not identifiable in advance. As a result, the arguments that limited liability would have been introduced in any situation are not valid in the context of MNEs’ tort.

Finally, the justice argument must be considered. Modern law systems are constantly trying to improve economic, social and legal systems in order to create better life conditions for human beings. Thus, legal principles and regulations for the future must be built on the aim of achieving justice. Consequently, the regulations must be justifiable covering every part of society. It is a fact that the economic development is definitely good for humanity but richness achieved at the cost of others’ disaster cannot be defended and thus cannot be claimed justifiable.

The problems of the limited liability doctrine show that the limited liability company for corporate shareholders is no longer justifiable, especially not in case of MNEs, which are professionally, legally and economically organised to be able to plan and insure possible liabilities so it is inconsistent to provide them the same protection as individual shareholders.
Evaluation of Risks and Problems in Limited Liability Corporate Groups

For many years corporations have benefited from the same protection via limited liability as have individuals even in the situation of holding the entire equity interest. Thus, economic units of MNEs enjoy great freedom to define their identities by dividing their activities between several distinct legal persons so that they ensure liabilities attaching to any one person will not also attach to the others in the group. Consequently, the key question in the case of tort, which person committed the wrong, is likely to receive an artificial answer when the wrongdoer has made use of the doctrine of separate corporate personality to redefine itself. Obviously, it is also unsatisfactory for plaintiffs if the artificial person said to have committed the wrong has inadequate funds to meet compensation.

On the other hand, the problems of limited liability are not restricted the problem of involuntarily creditors. In many areas of practice problems might arise; shareholders might manipulate their control holdings, the accounts of the group or an affiliate in the group may be misled, they might dominate the minority interest very easily and finally they can avoid taxation, anti-trust, monopoly and other regulations. However, the present study focuses on the liability arising from tort committed by subsidiaries.

The problem of liability occurs in practice in a way that according to existing Common Law practice a parent corporation could always choose to split itself up into separate corporations, making sure that those subsidiaries dealing with risky activities held the minimum assets possible because MNEs always try to ensure effective way of profit transfer when they are negotiating FDI agreements. A plaintiff would then only be able to obtain a successful recovery of damages if it could establish a chain of primary

288 Leebron, Limited Liability, (n 260)
duties leading back from an exporting company to those in the group of companies with sufficient assets to satisfy any judgement. After the *Adams v Cape Industries*\(^{292}\) and *Multinational Gas*\(^{293}\) cases such an approach is, for the moment, extremely unlikely because it was held that the courts are not free to disregard the principles of *Salomon* merely because they consider that justice requires it.\(^{294}\) More importantly, it was not fraudulent for a group of companies to use the doctrine of separate corporate personality in such a way as to minimise its group exposure to future liabilities.\(^{295}\)

No courts, since *Salomon*, in any case involving the legal responsibility of a parent corporation for the acts of its subsidiary, has examined as a matter of first consideration whether the doctrine of limited liability shielded the other companies in the group from liability for the debts of a subsidiary in the typical multi-tiered MNEs in the modern economy, and this has resulted in three, four, or even more separate layers of limited liability. Acceptance of this wide interpretation of limited liability allows for an illegitimate shifting of risk from a subsidiary to the involuntary creditors of the MNEs.\(^{296}\) Therefore, in mass tort cases, the assets and personality of the entire group may be needed to ensure a sufficient capital fund from which to satisfy claims. This is very justifiable where it is a fact that the group acts as an integrated economic entity, which together creates the prosperity of the enterprise.\(^{297}\)

Where injuries are severe and tort victims not fully insured, social justice requires that shareholders would be better risk bearers than tort victims particularly in respect of

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291 Hadden, Regulating Corporate p. 359 (n 226)
292 [1990] 2 W.L.R. 786
293 *Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd and Others* [1983] 2 AER 563
294 Detailed discussion is at chapter 3.
297 Muchlinski, Holding Multinationals, (n 296)
MNEs. Especially after mass tort actions of small and undercapitalised entities, the problem was considered critical. Therefore, in order to evaluate group liability for subsidiaries' tort actions, one needs an appropriate model; traditional legal thinking is not sufficient. Blumberg reflects that the concept perhaps accurately reflected the era in which it was developed -when individual shareholders were investors and were not active in the operation of the corporation- and he questions whether it does so today. Blumberg answers to the question; this development occurred without much critical analysis of the issue of limited liability of corporate groups and thus he argues that limited liability of corporate groups, one of the most important legal rules in modern economic systems, appears to have emerged as a 'historical accident'.

In another approach the problem of liability in MNE tort creates a conflict between economic realities and legal principles. In particular, legal regulations have failed to reflect the economic challenges in practice where the limited liability of companies under a group for the debts of its subsidiary does not provide social benefits. Contemporarily, the nature of the challenge is that legal systems of the world are confronted by revolutionary changes in corporate structure and operation caused by the emergence of corporate groups, particularly MNEs. The legal system that could largely resolve the legal problems presented by the early period of the Industrial Revolution is incompetent in its established form of dealing effectively with the problems of the multi-tiered MNEs functioning with a parent corporation, sub-holding companies and hundreds of subsidiary corporations organised under the laws of countries around the world. Particularly, the social cost-benefit evaluation is questionable where companies

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298 Leebron, Limited Liability, (n 260)
300 Cashel, Multinational Challenge (n 227)
301 Blumberg, The Multinational Challenge p. 57 (n 228)
302 Blumberg, The Multinational Challenge p. IX (n 228)
own all the stock or have complete control of their subsidiary corporations or operate as a complex group under which the separation is barely noticeable.\textsuperscript{303}

It would be unfair to claim there is no discussion of the liability problems in legal regulatory environments since the problems have triggered some discussions in different branch of legal professionals as well as in parliaments. However, finding its legitimacy in economic theory, limited liability, in legal theory, has only been criticized and all the attempts have been concentrated on reducing its negative affects instead of elimination. Therefore, the issue of limited liability within corporate groups has not received a sufficient degree of legislative attention. Accordingly, the case law has touched the problem very delicately under the principle of veil piercing.\textsuperscript{304} In legislative attempts, the last Company Law Review in the UK failed to break out of that cast, concluding in their report that there is no problem relating to liability of corporate groups. Thus new Companies Act \textsuperscript{2006} has no regulation on this matter.\textsuperscript{305} This disappointing development has turned all eyes on the regulations at European Community level that group specific laws, which are needed to protect creditors, will receive detailed debate in the light of developments.\textsuperscript{306} However, the EU Plan\textsuperscript{307} does not offer any solutions for groups of companies relating to liability issues, even worse, they do not see any problem relating to liability issues under groups of companies.\textsuperscript{308} Moreover, it must be stressed that the problem is not that there is a lack of laws and regulations relating to corporate groups but, although there are a great quantity of laws in the area, these laws often do not address the issue of groups such, but rather deals with what are some of the relevant

\begin{thebibliography}{99}
\bibitem{304} Detailed discussion is made at chapter 4.
\bibitem{305} Detailed discussion is made at chapter 4.
\bibitem{308} Detailed discussion is made at chapter 4.
\end{thebibliography}
regulatory problems of company law and in the process also covering the issue of groups.

**Evaluation of Creditors’ Classification**

In accordance with liability clauses, it is highly possible that firms with limited liability will undertake projects with too much risk. Firms will capture the benefits from such activities while bearing only some of the costs; while shifting other costs to creditors; this is a real cost of limited liability.\(^{309}\) The main argument put in terms of economic analysis is that it externalises the loss through uncompensated transfers of risk to creditors; the objection was met by pointing out that the risk transfer was in fact fully compensated by other economic benefits to the society or creditors such as higher interest rates. With a tort creditor, the economic analysis produces a problem since it is clear that the loss ineffectively externalised; the tort victim is not in a position to bargain for a compensating benefit or to avoid or monitor the risk to which the company is exposing them.\(^{310}\) Therefore, legal systems must distinguish contractual creditors who choose to maintain a relationship with the company and non-contractual creditors that are in the position of acquiring creditor status without any intentional relationship with the corporation.\(^{311}\) Thus, voluntarily and involuntarily creditors must be treated separately.

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Evaluation of Legal Principles of MNEs

Professor Schmitthoff's claims that the question of limited liability of the parent company for the torts of a subsidiary under certain well-defined conditions is one of the great-unsolved problems of modern company law. The historical overview amply demonstrates that limited liability did not emerge as necessary attribute of corporate personality but as a legal means of achieving a major economic and social purpose, which was encouraging more people to participate, as members of companies in economic activity. This means the legal rule of limited liability emerged in order to serve economic social necessities of the times. The applicability of limited liability has not changed since its emergence but its area of application has extended to company shareholders and thus to group of companies.

However, the limited liability company theory ignores contemporary economic realities because parent companies and their subsidiaries are collectively conducting a common enterprise so the limited liability doctrine, which is designed to protect shareholders not enterprises themselves, has lost the support of economic efficiency argument in the case of corporate groups. Therefore, application of economic theory for limited liability to the groups of companies has no impact on the investment decision of shareholders of the group. Also in economic arguments for companies, any economic goal that can be achieved by the creation of a wholly owned subsidiary could equally be achieved by the formation of a division within a single corporate entity.

It is obvious that when the responsible party is a subsidiary of a larger corporation, the plaintiffs may forcefully argue in the courts that the corporations under common and

313 Blumberg, The Multinational Challenge p. 59 (n 228)
314 Note, Liability of Parent, (n 255)
cross-ownership should be held legally responsible for the tortious acts of its subsidiary.316 For this purpose, plaintiffs will be able to base their argument on theories for the liability of parent corporations and search for existing liability under tort law, corporate law and the existing case law, which is mainly based on the piercing the corporate veil doctrine.

In tort law the English cases Cape Industries317 and Thor Chemicals318, for example, have effectively been based on an argument that the parent company’s involvement in the day-to-day management of the relevant overseas facility was such that it should be directly responsible for injuries sustained as a consequence of operations technically carried out by another company in the group.319 However, the problem of proving the existence of a duty of care, and of its breach, must be kept separate from the wider issue relating to the extent to which groups of companies could benefit from the principle of limited liability as a means of protecting itself against tort claims arising out of the actions of its subsidiaries.320 Therefore, it is important to examine whether excessive control per se will result in certain legal consequences, in particular, the collapse of the limitation of liability between the parent corporation and its subsidiary, or whether additional elements are needed.321

As a result of current case law in order to get compensation from the English and American parent company in the American and English courts, the plaintiffs would have to overcome the reluctance of the common law of tort to make one person responsible for the acts of another outside the agency sphere of vicarious liability. To do this, they would have to show one of two things; either that the parent company had broken a primary duty of care; or that the doctrine of separate corporate personality should be

316 Farmer, Parent Corporation Responsibility, (n 261)
317 Adams v Cape Industries [1990] 2 WLR 786
318 Sithole and Others v Thor Chemicals (LTL 2/3/1999)
319 Ward Halina, ‘Governing Multinationals: The Role Of Foreign Direct Liability’ (Briefing Paper Of The Royal Institute Of International Affairs, Energy And Environment Programme, no 18, February 2001)
320 Muchlinski, Holding Multinationals, (n 296)
321 Lutter, Enterprise Law Corp (n 218)
disregarded so as to make the parent vicariously liable for the acts and defaults of its subsidiary.\textsuperscript{322} Under the case law, many creditors felt that these companies were little more than scams designed to prevent the individual from being liable for his business debts and on a number of occasions the courts agreed and made the key individual liable by claiming either that there was an agency relationship or that the incorporation should be set aside as a façade.\textsuperscript{323} However, English law offers the foreign plaintiff virtually no prospect of success against English defendants on the basis of vicarious liability in the light of the Court of Appeal’s approach to corporate personality in the \textit{Adams v Cape Industries} case. Which means English courts takes the problem under tort law and search for the breach of primary duties. Therefore, the foreign plaintiff, in theory, has a better prospect of success in arguing that the English defendant has breached some primary duty owed directly by it.\textsuperscript{324} Unfortunately, so far, none of the major foreign liability cases has resulted in a clear win for the plaintiffs on the substantive issues, though some cases have resulted in out of court settlement. Thus, taking the argument in the direction of tort rules creates no solution except for discovery that hopes for effective solutions end at deadlock.

In short, the application of limited liability was not an obligatory characteristic of company law, but rather a political decision of states and countries to make investments for companies more attractive for individuals. Thus, supporters of limited liability do not base their arguments on the idea of necessity of limited liability for corporate law, but rather support economic and practical efficiency and the unavoidability of limited liability for capital markets and companies. Thus, it can easily be claimed that using economically efficient systems for limited liability is a somewhat overworked term.\textsuperscript{325} This means a limited liability company does not represent anything more than the economic and political preferences of states. And the increasing use of the corporate

\begin{itemize}
\item \textsuperscript{322} Baughen Simon, \textit{Corporate Accountability and The Law Of Tort: The Inclusive Verdict Of Bhopal} (University of Manchester, 1993)
\item \textsuperscript{323} Ward, \textit{Governing Multinationals}, (n 319) and Bowmer, \textit{Company law}, (n 249)
\item \textsuperscript{324} Baughen, \textit{Multinationals}, (n 290)
\item \textsuperscript{325} Fridman S, ‘Removal Of The Corporate Veil: Suggestions For Law Reform in Quintex Australia Finance Ltd. v Schroders Australia Ltd.’ (1991) 19 ABLR 211
\end{itemize}
form for businesses, together with the recent arrival of potentially massive tort liability, suggests that the issue should be reconsidered. 326

Since the origins of states several thousand years ago, the governors have regularly created rules for economic activity, responding to citizen demands and seeking to create a wealthier society. The modern nation state followed in this long tradition; they have created rules to increase the wealth in a society. On the other hand, citizens increasingly demanded new and stronger rules to protect them in the era of nationally based capitalism. Rules that would restrict investors and companies in order to prohibit child labour, assure healthy foods and drugs, guarantee the safety of transportation, and support the stability financial markets can be given as examples. 327 Now the demand to protect society against limited liability corporate groups is increasing. The national democratic state, which represents the most effective system, cannot ignore this demand any more.

Evaluation of the Chapter

The basic legal systems in the world consider companies as economically and managerially independent units so the laws recognise this independence and grant companies legal personality. In this situation, if one questions the separate personality theory of companies and its sources, independence theory must be the centre of the examination. Economic scholars have already started to question separate corporate personality in the case of corporate groups since economic and managerial structures of subsidiaries are dependent on the wills of another company, in some cases with no

common ownership except for being under the same MNEs. However, in law, the theory and practice have been built on the separate legal personality and instead of changing it; developments in the case and statutory laws have just strengthened its applicability since its emergence in the 19th century. The economic activities of companies have been globalised; the MNEs have gained social characteristics, and turned to be one of the phenomena for the new world order. The international economic institutions and in some cases, states recognise MNEs as international economic actors. Thus, the recognition of MNEs has been settled socially and economically. What the law should reflect is the social and economic developments in society. However, corporate law has failed to reflect the developments; instead it still follows principles of a case, which was decided more than 100 years ago.

The law has failed to absorb the new circumstances that permitting companies to hold shares of another company created. It showed almost no reaction to regulate the new situation. This failure can be mentioned as the source of many of the problems we are discussing in this thesis. The law has failed to recognise the fact that enterprises organised themselves as a group when they are operating cross-border as well as in a domestic market. Although, this fact is very obvious, the law still insists on the theory of separate corporate personality. Therefore, the law has failed to respond to the challenges that MNEs, one of the modern time greatest phenomenon, created. The law has even failed to reach a legal definition of MNEs. Even though the investment theory of MNEs suggests different realities than efficiency arguments of limited liability rules suggest, there has been no action to change the law that grants limited liability protection to the groups of companies similar to individual shareholders. Thus, the examination of MNEs economic history and current economical social characteristics indicate that limited liability is not a necessary element of the existence and operation of MNEs. Thus, the law failed to understand these realities, which cause problems in practice when there are claims for tort liability of MNEs.

The law has failed to react to the developments of new structural organisations of MNEs. The practice and the theory still consider MNEs as vertically integrated companies that have one top and many sub-equal divisions. However, the structure,
fIrstly, changed to be multidivisional; the law hardly responded to these changes. And then matrix and regional integration came; the law demonstrated no alterations in its approach. With the emergence of horizontally structured MNEs, the law seems to have lost control over regulation for MNEs. Thus, the new structural organizational realities must be considered when dealing with any rules of liability in the MNEs context.

Accordingly the complex social, economic, managerial and legal structures not only make reaching liability difficult but also cause MNEs to commit torts. The pressure applied by the group’s central managements over subsidiaries to be cost efficient and profitable is excessive. Accordingly, managers of subsidiaries work under the pressure of high expectations set by groups as whole. Thus, their efforts have always concentrated on maximising profit and success in business. Therefore, it is not abnormal for subsidiaries to use the social and economic power of the group and exploit any legal ambiguity. The wider examination and better legal regulation of MNEs will have positive effects on preventing the corporate tort.

Under these conditions the question must be to what extent we can claim separate corporate personality? What is the end for separate company theory under a group structure? How could the new and complicated horizontal structures and cross-ownerships affect the current principles? Can modern legal systems still pretend that existing law is fair and needs no revision? Or is it time to go for real and effective solutions? The author thinks the time has already come for reconsideration of legal principles that determines the area of company law and tort liability. Lawmakers in national and international level should take immediate steps to create solutions based on these new findings of interdisciplinary characteristics of MNEs.

Furthermore, the examination should focus on the definition of MNEs; of course firstly a comprehensive definition of the concept of MNEs must be produced in law. The MNEs proudly call themselves a group and even give facts about their group activities. We can give Bayer as an example. The following fact directly taken from its website: “Bayer is represented by some 350 companies (as of December 31, 2003). The cornerstones of its business activities are in Europe, North America and the Far East. In 2003, Bayer employed some 115,400 people and had sales of EUR 28.6 billion. The
capital expenditure budget for the current year is EUR 1.8 billion, the R&D budget EUR 2.3 billion.\textsuperscript{328}

It is interesting that even though MNEs name themselves as a group and regulate all their activities accordingly but the law still insists regulating them as separate and independent companies. This increases the need to make comprehensive examination of MNEs; the present chapter is devoted to producing a definition and basic characteristics of MNEs. After indicating the interdisciplinary basics of MNEs, the next step must be building comprehensive legal responsibilities for MNEs. The companies are given legal personality because they are considered economically and managerially independent units. Now, not only companies but also MNEs are economically and managerially independent units. The MNEs have a management board for the group; they provide financial reports for the group. They have disclosure requirements for the group. They are also keen to develop CSR for the group. These new aspects of MNEs have different characteristics from a company's basic characteristics. For this reason, the new regulations must be built on the facts of new social, economical and organisational structure. As already mentioned, the new structure, developed from vertical structure to the horizontal structure, can provide adequate regulatory framework for all differently structured MNEs. With this new conception of MNEs, there must be reconsideration of legal principles that prevents the achievement of MNEs liability for their subsidiaries' torts.

In conclusion, the present chapter has aimed to indicate the interdisciplinary characteristics of MNEs from social, economic, managerial and legal studies. The findings indicate that the developments in social and economic and managerial studies have not been met by developments in legal studies. Therefore, this situation creates problems since the basic legal principles are outdated and the same principles, when applied in practice, cause problems in the area of tort liability of MNEs. This requires us to check applicable laws and practice and proposals by questioning how they are suited

\textsuperscript{328} \url{http://www.bayer.com} accessed 25 November 2005
to the contemporary understandings of groups of companies and MNEs. In other words, there should be reconsideration of law and principles applied in MNEs torts.
CHAPTER III: JURISDICTIONAL PROBLEMS

Introduction

Reaching the justified liability of MNEs‘ tort is blocked not only by problems of substantive company law but also many procedural and jurisdictional problems. In other words, the complex design of international private law presents significant obstacles to suing MNEs in the venues in which they can be held liable. Therefore, in transnational litigation, past experiences have illustrated the complex interplay between principles of substantive corporate law and procedural rules of international civil litigation.¹ Even though litigation is supposed to be the last resort as a means of ensuring that MNE groups comply with standards and duties of care in relation to their hazardous operations, it plays a very important role because the choice of law issues and interpretations of law are determined usually according to the law of the forum states.² Moreover, the power of MNEs and the inefficient legal structure of host countries prevent plaintiffs reaching satisfactory compensation.

Commonly, people who have been injured as a consequence of the tortious activities of MNEs subsidiaries sue the companies in the forum of the parent company’s state to benefit from its legal systems’ advantageous structure. However, many of the cases brought in the forum of the UK and the USA have been dismissed on the ground of the principles of forum non conveniens under which the American and English courts considered the host states’ forums distinctly and clearly more appropriate to hear the cases.

¹ Magaisa AT, ‘Suing Multinational Corporate Groups for Torts in Wake of the Lubbe Case‘ (2001) 2 Law, Social Justice and Global Development 1

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When there is a tort committed by a subsidiary of MNE, plaintiffs have a number of options for starting legal actions; first to sue the subsidiary in the host country. However, as discussed earlier there is very little possibility of success due to inadequate and unfair justice system or insufficient capital sources of subsidiaries or the basic problem of limited liability companies. The second possible action is to sue the parent corporation in their country of domicile. This seems the only logical option for plaintiffs to be awarded satisfactory compensation. However, the problem of independency theory and limited liability theory force the plaintiffs, lawyer and judges to think about the possible establishment of tort liability for accused companies. The other possible way is to sue other companies under the group, which may be domiciled in the same jurisdiction or a different jurisdiction. This option has not been tried yet because it is a breakthrough departure from existing rules, even though it could bring a different perspective to the examination of liability of MNE groups. However, the possible acceptance of jurisdiction over other subsidiaries for each other’s tort requires establishment of group liability based on the modern structure of MNEs.

Even when jurisdiction has been achieved over the corporations in home states, courts have the discretionary authority to decline to hear the case under the doctrine of forum non conveniens. Under the principle, American courts behave very strictly on the application of principle while in the UK courts are comparatively more flexible, especially after the recent Lubbe v. Cape Industries cases.3 On the other hand, civil law countries have solved the problems by not employing the forum non conveniens doctrine. The question of jurisdiction of civil law courts is unproblematic when the defendant is based in the countries where they have been sued. Both under Civil law and under the Brussels Convention, the rule of the so-called forum rei applies; jurisdiction of the court of the defendant’s domicile. This is the main rule on jurisdiction in article 2 of the Brussels Convention. Thus, in normal civil proceedings before Civil Law courts any

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2 Muchlinski P, 'Holding Multinationals to Account: Recent Developments in English Litigation and the Company Law Review' (2002) 23 Company Lawyer 168

consideration of *forum non conveniens* does not apply.\(^4\) The principles of Brussels Convention and decisions of European Court of Justice have brought application of *forum non conveniens* doctrine in the UK closer to application in the EU countries.\(^5\)

Consequently, the jurisdiction problems are the first problems that a plaintiff will face on the way to suing an MNE and thus they have an important effect on the provisions of MNEs' liability. Accordingly, under this chapter, general jurisdiction rules on companies and the common law approach to the problem of jurisdiction in case of MNEs litigation will be explained. The *forum non conveniens* doctrine will be the centre of argument and the applicability of current principles will be discussed in accordance with the general characteristics of MNEs that are discussed in the previous chapter. There is a test of existing jurisdiction whether they have capacity to solve the problems that modern structure of MNEs creates. Later the possible ways to elimination of jurisdictional obstacles will be discussed. Particular attention is given to the Alien Tort Claims Act under which there is an examination of whether it is an efficient model to solve the problems.

**Jurisdictional Rules for Companies and MNEs**

According to The Civil Jurisdiction and Judgments Act 1982, the jurisdiction rules for companies can be summarized as follows; a corporation may be sued in the courts of the state where: 1- it has its statutory seat or is incorporated, or under whose law is formed; 2- it has its central administration; or 3- its business, or other professional activity is

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\(^5\) The topic is discussed in detail below. (p 138)
principally carried out. Accordingly, the seat of a company shall be treated as its domicile and in order to determine that seat; the court is to apply its rule of internal law. In the United Kingdom the statutory seats means the registered office, or if there is no such office, the place of incorporation or, if there is no such place, the place under the law of which the formation took place.

On the other hand, there are specific jurisdiction rules; 1- a corporation may also be sued in the courts of a state where it has a branch, agency or other establishment, in respect of a dispute arising out of its operations in that state; 2- where a corporation operates in a state through a subsidiary or other related corporation in circumstances where that second corporation has no independent existence in fact, since the first corporation takes all material decisions as to the conduct of the business of the second corporation, the second corporation shall be treated as a branch of the first corporation for the purposes of the preceding rule; 3- a corporation may also be sued in the courts of a state in respect of a claim arising directly out of an activity carried out by that corporation in that state.

In common law countries the establishment of a local branch or the provision of a local address for service has traditionally led to general jurisdiction. Thus, the key question may arise in what circumstances a local subsidiary may be treated as a branch of the parent company. This issue is of particular importance in cases where a group of corporations operates as a unified economic network especially under horizontal organisation. However, as regard the meaning of the word of branch, it has been

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7 The Civil Jurisdiction and Judgments Act 1982 art. 53(1) see Collins, *Dicey and Morris* p. 287 (n 6)
9 The Civil Jurisdiction and Judgments Act 1982 art. 5(4)
10 Collins, *Dicey and Morris* p. 299 (n 6)
11 The Civil Jurisdiction and Judgments Act 1982 art. 5(3) see Collins, *Dicey and Morris* p. 328 (n 6)
12 The Civil Jurisdiction and Judgments Act 1982 art. 5(4)
13 Detailed discussion is at chapter 2.
agreed that a subsidiary is not a branch. Therefore, any other corporations cannot be sued for the activities of subsidiaries if plaintiffs do not claim any particular tort against them, or there exists another exemption by the statutory or case law. The matter has been considered in the EC Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters (the Brussels Convention). The Brussels Convention Art 5(5) creates special jurisdiction over companies “as regards a dispute arising out of the operations of a branch, agency or other establishment,” Thus companies can be sued “the courts for the place in which the branch, agency or other establishment is situated”. If the branch is not an independent legal person it could not be sued at all and the result of this provision is that the legal entity constituting the corporation may be sued not only at its own seat but at the place of the branch as well. As it is clear from the phrasing of the Convention, subsidiaries are not considered as branch or agency. The practice in international civil litigation and domestic litigation has apparently shown that subsidiaries cannot be classified under the ‘other establishments’ either since subsidiaries are considered independent legal personalities.

Domicile

The Civil Jurisdiction and Judgment Act 1982, which incorporates the Brussels Convention into United Kingdom law, enacted distinct rules governing jurisdiction in cases concerning such matters where the defendant is domiciled in a member state of the EU, as well as rules governing jurisdiction over defendants domiciled in other parts of the United Kingdom. The Civil Jurisdiction and Judgments Act 1991 enacted into United Kingdom law the parallel Convention of 1989 with countries, which are

16 Betlem, Transnational Litigation, (n 4)
members of the European Free Trade Area (the Lugano Convention). There are thus four sets of rules respecting domiciles of companies; (i) EU domiciliary, (ii) EFTA domiciliary (iii) domiciliary of the United Kingdom, and (iv) the rest of the world population.\textsuperscript{17}

Determining domicile for defendants is a jurisdiction issue so it is not related to parent companies' liability for subsidiaries' tort. Actually, there is not much legal problem in determining the domicile of English parent corporations. The 1982 Civil Jurisdiction and Judgments Act\textsuperscript{18} provide that "a company has its seat and, therefore, its domicile in the UK if it was incorporated or formed under a law a part of the UK and has its registered office or some other official addresses in the UK". This Act was made law in accordance with Brussels Convention article 53.\textsuperscript{19} The article provides that "in order to determine that seat the court shall apply its rules of private international law".\textsuperscript{20} Additionally, the European Court of Justice (ECJ) decided in a case that Brussels Convention is applicable where the defendant has its domicile or seat in a contracting state, even if the plaintiff is domiciled in non-contracting country.\textsuperscript{21}

The seat of a company constitutes its domicile and must be determined by the court's private international law in which in the UK refers to the doctrine of incorporation. Actually, the concept of seat of corporation has no precise equivalent in the law of United Kingdom and it was necessary to provide expressly in the 1982 Act for the determination of corporations. Therefore, s. 42 of 1982 Act provides that a corporation has its seat in the United Kingdom if and only if (a) it was incorporated or formed under the law of a part of the United Kingdom and has its registered office or

\textsuperscript{17} Collier JG, \textit{Conflicts of Law} (Oxford University Press, Oxford 2001) p. 72
\textsuperscript{18} 1982 Civil Jurisdiction and Judgments Act s. 42
\textsuperscript{19} Darcy LC and Murray B, \textit{Cleave Schmittoff's Export Trade} (Sweet & Maxwell, London 2000) p. 442
\textsuperscript{20} 1982 Civil Jurisdiction and Judgments Act art. 52(1)
\textsuperscript{21} Societe Group Josi Reinsurance Company v Campagnie d's Assurances Universal General Insurance Company Case 412/98 (ECJ 13 Jul 2000)
some other official addresses in the United Kingdom or (b) its central management and control is exercised in the United Kingdom.\textsuperscript{22}

There is difference between the common law understanding and the Convention that there is no question of the need for permanent home under the 1982 Act, thus under the 1982 Act, it will be possible for a person to have more than one domicile, whereas in common law only one domicile is possible.\textsuperscript{23} Therefore in determining the seat of Panamanian company with its central management and control in Germany, it will have its seat for the purpose of the 1982 Act both in Panama and in Germany.\textsuperscript{24}

The important problem with domicile is the presence of the defendant company. The company has to be present in the jurisdiction at the time the proceedings are started. In \textit{Adams v Cape Industries Plc}\textsuperscript{25}, the Court of Appeal confirmed that such 'presence' would not be established merely through the presence in the foreign jurisdiction of either a subsidiary company or a company.\textsuperscript{26} In order to establish jurisdiction in case of subsidiary involvement there is a necessity for an investigation of all aspects of the relationship between the subsidiary and the parent because the current law in the UK still relies on traditional notions of agency.\textsuperscript{27} Under the agency rules, the relationship between the parent and subsidiary must be similar to the one in agent and principal.\textsuperscript{28} In the United States courts look at the economic realities of the situation; if the parent and subsidiary form an economic unit it should be possible to establish jurisdiction on the basis of presence of its subsidiary or indeed against a foreign subsidiary on the basis of the presence of the parent in England.\textsuperscript{29} This is a more logical approach and would be very helpful to create better jurisdiction coverage for MNEs. However, the establishment

\textsuperscript{22} Collins, \textit{Dicey and Morris} p. 288 (n 6)
\textsuperscript{23} Collins, \textit{Dicey and Morris} p. 287 (n 6)
\textsuperscript{24} \textit{The Diechland} (1990) 1 Q.B 361, See Collins, \textit{Dicey and Morris} p. 288 (n 6)
\textsuperscript{25} [1990] 2 WLR 786
\textsuperscript{26} Baughen S, 'Multinationals and the Export of Hazard' (1995) 58 MLR 54
\textsuperscript{27} Collins, \textit{Dicey and Morris} p. 299 (n 6) and North and Fawcett, \textit{Cheshire and North's} p. 295 (n 14)
\textsuperscript{28} Detailed discussion is made at chapter 3.
\textsuperscript{29} North and Fawcett, \textit{Cheshire and North's} p. 295 (n 14)
of economic unity in the MNEs context is not totally different from establishment of agency relationships.

Accordingly, determining domiciles of companies under MNEs is very complex since there is no legal institution called an MNE. Thus, each company is considered as independent legal units and in each case the domiciles of companies is examined independently. Mere existence of ownership relationships between the subsidiary and the parent does not necessarily create jurisdiction over a parent by the forum of the subsidiary nor does it create jurisdiction over the subsidiary by the forum of the parent company. As a result, similar to establishing liability over MNEs, establishing domicile and thus jurisdiction over all components of MNEs is not possible. Even establishing domicile and jurisdiction over parent or subsidiary outside of their incorporation state needs to be decided after a detailed examination of general and specific jurisdiction rules created by the complex rules of private international law.

Accordingly, under this adopted Common Law rule, English courts have jurisdiction for each company that is domiciled in the UK. This means that the plaintiff is entitled to choose the jurisdiction of the court, but on this point the doctrine of *forum non conveniens* provides an interpretation gap for the case not to be heard in the UK and the USA legal system has similar characteristics.\(^{30}\)

Therefore, the question of jurisdiction rules for MNEs is apparently too compound because it depends largely on the laws of a mixture of states. In many circumstances, the issue is left with an apparent difficulty in the international system which emerges in a number of situations; any state where a section of an MNE is based lacks the territorial jurisdiction to regulate the activities of subsidiaries located abroad, while the host states in which the subsidiaries are located lack jurisdiction over any other components with whom they constitute integrated economic network.\(^{31}\) In these circumstances, MNEs


\(^{31}\) Lutter M, 'Enterprise Law Corp. vs. Entity Law Inc. - Philip Blumberg's Book from the Point of View of an European Lawyer' (1990) 38 American Journal of Comparative Law 949

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exploit a degree of independence from national jurisdiction that is unique in the global legal order.\textsuperscript{32}

As a result, there is, in theory, no court in the world that exercises jurisdiction over all the components of an MNE.\textsuperscript{33} For this reason, the plaintiffs have to sue corporations according to tort law principles in the home countries or host countries. They cannot sue corporations in the host states where they are not domiciled unless there are exemptions. Consequently, they have to choose home countries' forums to sue the other companies under the group. Here appears another obstacle, common law doctrine of \textit{forum non conveniens}.

\textbf{Forum Non Conveniens}

\textit{Forum non conveniens} is a common law doctrine that allows a court to dismiss a case, although personal jurisdiction and venue are proper, on the reason that there is another forum, which is more appropriate.\textsuperscript{34} It is a creature of equity and only defendants can claim \textit{forum non conveniens} because plaintiffs are entitled to original choice of forum.\textsuperscript{35} \textit{Forum non conveniens} was originally invoked to protect the defendant from being harassed by a plaintiff choosing a genuinely inconvenient or inappropriate forum. Despite this intent, it has in many instances become a device for MNEs to escape liability for tortious acts committed abroad by its subsidiaries.\textsuperscript{36}

\begin{itemize}
\item \textsuperscript{32} Anderson, Transnational Corporations, (n 30) and Ward Halina, ‘Corporate Accountability In Search Of a Treaty? Some Insight From Foreign Direct Liability’ (Briefing Paper Of The Royal Institute Of International Affairs no 4 May 2002)
\item \textsuperscript{33} Anderson, Transnational Corporations (n 30)
\item \textsuperscript{36} Anderson, Transnational Corporations (n 30)
\end{itemize}
In the cases that *forum non conveniens* are applied by English and American courts it is frequently MNEs that are defendants in actions brought by foreign plaintiffs for injuries that have occurred in a foreign country. The implications of *forum non conveniens* doctrine are quite different in the voluntarily creditors context as opposed to the involuntarily creditors context. In the former cases, the commercial parties are usually contesting a forum because they wish to secure the best deal for themselves. Moreover, dismissing the case or transferring it to another country has little effect on the final solution because of the certain commercial characteristics of disputes. Under the latter cases foreign plaintiffs are in a weaker position since they have been exposed to tort involuntarily. They have no chance to negotiate for the choice of forum. In contractual disputes, plaintiffs might have a clause to determine the forum where disputes will be settled. However, in the disputes where there are no prearranged forum clauses, there is still space for the application of *forum non conveniens*. That is why, in many contractual disputes *forum non conveniens* has been applied and it is not unusual to see application of *forum non conveniens* in contractual disputes quite often. However, the emphasis will be on application of *forum non conveniens* in the context of tort victims.

Tort victims choose the UK and the USA courts because they find the courts attractive for obtaining better punitive awards. On the other hand, defendants consider *forum non conveniens* as a part of litigation strategy since cases are usually moved to distinct forums where they end with a little punitive award or sometimes with no award. For example in the *Bhopal* case, the conflict was settled for far less than what would have been a jury’s award in the USA.

The *forum non conveniens* doctrine gives too much discretion and there is too little clarity in its application. There are two kinds of applicable version of *forum non

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37 Duval-Major, One-Way Ticket Home, (n 34)
38 Bhopal case, Union Carbide Corp. Gas Plant Disaster at Bhopal, India in December 1984 F. Supp. 8 42
39 Birnbaum SL and Dunham DW, 'Foreign Plaintiff And Forum Non Conveniens' (1990) 16 Brook. J. Int'l. L. 241
conveniens: the abuse of process version and the most suitable forum version. The forum non conveniens doctrine was substantially based on abuse of process by the plaintiff till the middle 1970s and the courts generally applied the abuse of process version, thus if they think there is another appropriate forum they dismiss the case on the ground of forum shopping rules. Defendants' first objection to plaintiffs' writs is usually that plaintiffs abuse the process since they have made the claim in the UK or the USA although there is a more appropriate forum. Dismissal for abuse of process was practiced by the courts before the 1980s in America and it was also in commonly used in England. Later, the USA courts have changed their approach because it was obvious that everybody has a right to sue companies in their home states under the rules of general jurisdiction. In the UK, in the Lubbe v Cape Plc, at all stages, the judges refused the claim for abuse of process. They agreed on the basis that battling to establish a forum in more appropriate forum must be considered as basic rights of plaintiffs. With the evaluation of the decision under the Lubbe case, it can be concluded that every plaintiff can try to establish a forum in a more appropriate venue. It should not be interpreted as an abuse of process, but instead, be considered the basic rights of plaintiffs. The access to justice and justice system is considered one of the basic human rights, thus in the cases that plaintiff think the English court should have jurisdiction over dispute arising activities of MNEs must be considered as legitimate rights of individuals on their attempt to access to the justice systems.

In the UK, forum non conveniens principles were clarified and made common principle under the Spiliada Maritime Corporation v Consulex Ltd case. The principles can shortly be explained in that a stay will be granted if the defendant shows that there is another available forum, which is clearly and distinctly more appropriate

40 Robertson DW, 'Forum Non Conveniens In America And England: A Rather Fantastic Fiction' (1987) 103 Law Quarterly Review 398
42 [1987] A.C. 460
43 Collier, Conflict of Law p. 88 (n 17)
than the UK forum. The plaintiff can only prevent the dismissal of the case if he can prove that justice cannot be obtained in the new forum. The approach of American and English courts towards *forum non conveniens* became very similar with the establishment of most suitable forum criteria by American courts. 44

Accordingly, there is a two-limbed test. In the first limb, the burden rests on the defendant to show not only that England is not the natural or appropriate forum for the trial, but also that there is another available forum, which is clearly, or distinctly more appropriate than the English forum. However, it is not enough for the defendant to establish a mere balance of convenience in favour of the foreign forum. The defendant has to show that there is a ‘clearly or distinctly’ more appropriate forum elsewhere, the court will grant the stay ‘unless there are circumstances by reason of which justice requires that a stay nevertheless not be granted’. In the second limb, the burden of proof shifts to the plaintiff to show that substantive justice cannot be achieved in the alternative forum. 45

Although the *Spiliada* rules are still central in cases related to *forum non conveniens*, it can be claimed that English courts’ approach towards to the doctrine has changed due to two recent decisions; those of *Connelly v RTZ* 46 and *Lubbe v Cape Plc*. 47. The *Cape Cases* concerned the claims made by employees of South African subsidiaries and other claimants who lived near the mining area. The plaintiffs claimed that they were exposed to asbestos during the period of time that the subsidiaries were active in the mining area. In 1997 two writs were issued by the plaintiffs’ solicitors. The first

44 Robertson, Forum Non Conveniens, (n 40)
45 Magaisa, Suing Multinational, (n 1)
46 [1998] AC 854, In *Connelly* the plaintiff had been employed in Namibia for a subsidiary of English parent company. He was a Scotsman who worked in Namibia for some time and came back to England. After returning he was diagnosed with cancer of throat. He sued the parent company in the UK because he thought that the justice was not achieved in Namibia for practical reasons. The legal aid was not available there and also medical witnesses were usually in England.
47 [2000] 1 W.L.R. 1545
action was on behalf of Rachel Lubbe and four others. The judge ordered a stay of the Lubbe action. Lubbe appealed the decision and the Court of Appeal lifted the stay. The defendant’s petition was refused by the House of Lords. After the House of Lords’ decision the same law firm issued a writ on behalf of Hedrick Afrika and 1538 others. The defendant applied and reapplied to stay the Afrika and Lubbe actions on the ground of forum non conveniens and/or abuse of process. The defendant submitted that the English court must not carry on with the case because under the Spiliada principles the South African forum is distinctly and clearly more appropriate for the trial of action. Although the Court of Appeal granted a stay, the House of Lords removed the stay.

The reasons for the removal of the stay by the House of Lords in the Cape Cases were similar to those of Connelly. There was no legal aid and contingency fee available to lawyers in South Africa and additionally, South African courts were not experienced enough to handle a group action. These two recent decisions point out that after evaluating private interest factors, if there is a possibility that justice may not be achieved, courts should decide that the cases can be tried in England. Additionally, the Thor chemical litigations opened the ways for English parent corporations to be sued.

48 Second action was on behalf of Vicenzina Gisondi and three others. These plaintiffs were Italian citizens so they had the right to bring a case against an English domicile company in the UK in accordance with the article 2 of Brussels Convention.

49 The Court of Appeal granted a stay on the ground that the alternative forum was available after the defendants’ submission. In addition, it was obvious that the action must proceed as a group action and in group concept, the South African forum was distinctly and clearly more appropriate. The private interest factors point the South African forum because essential documents are in South Africa, nearly all witnesses are there and medical evidence is also reachable there. For legal aid problem, the decision was that it might not be possible to get legal aid in South Africa but it does not make it necessary to set up forum in the UK. In addition, the judge though that if the case is kept in the UK, there may be some procedural problems related to examining evidences in South Africa.

50 Collier, Conflict of Law, p. 93 (n 17)

51 Sithole and Others v Thor Chemicals (LTL 2/3/1999) In the case, plaintiffs claimed damages for personal injury or loss of support arising from the death of breadwinners also looked to a parent company, this time of a mercury processing plant. It was alleged that the parent company had been advised by the health and safety authorities in the UK that the process adopted in the UK Company was potentially injurious to employees’ health. Notwithstanding that, the parent company exported the process, in a substantially unchanged form, to an operation in Cato Ridge, KwaZulu-Natal. In that matter, the defence of forum non conveniens was also raised but dismissed by the House of Lords.
in the UK. However, it remains to be seen whether the Cape and Thor litigation open the way to further cases against UK-based MNEs.52

On this level the influence of the ECJ on UK law must be discussed. The UK enacted the Civil Jurisdiction and Judgment Act 1982, which is based on Brussels Convention. The Act was regulated under characteristics of the Civil Law, and took place in 1987. Consequently there has been no dispute in the UK about the appropriate forum in relation to plaintiffs who are from other member countries. In the Cape case, for the Italian plaintiffs the defendant did not appeal against the case since they are from a member state of Italy. However, English courts were reluctant to abandon the forum non conveniens doctrine, but this approach has been reinforced by Group Josi Reinsurance Company SA v Universal General Insurance Company judgment of the European Court of Justice (ECJ) in July 2000.53 The ECJ has extended the general principle established by the Brussels Convention that defendants can be sued in the courts of the EU member state in which they are domiciled. The English courts refused to accept the principle in cases where the alternative court was located in a non-EU country.54

The Brussels Convention has been superseded by Council Regulation on the jurisdiction and recognition and enforcement of judgments in civil and commercial matters55 so far as Article 2 is concerned the Regulations are materially the same as the Brussels Convention. The English Court is required to apply the rules set out in the Brussels Regulation on Jurisdiction and Recognition and Enforcement of Judgments in

52 Ward, Corporate Accountability, (n 32)


54 Re Harrods (Buenos Aires) ltd [1991] 4 All E.R. 334. The Court decided that the domicile principle in the Brussels Convention has no application to cases where there is a choice of jurisdiction between the English forum and the courts of a non-Convention country. In such a case the forum non-conveniens doctrine will apply by virtue of Article 49 of the Brussels Convention.

Civil and Commercial Matters. Therefore, the recent Owusu v Jackson\textsuperscript{56} decision has continued that trend by curtailing the ability of the English court to invoke the doctrine of \textit{forum non conveniens}.

Mr. Owusu, the claimant, a British national domiciled in the United Kingdom, suffered serious injuries in Mambee Bay, Jamaica, when he struck his head when swimming against a submerged sandbank. Mr. Jackson, the first defendant, also domiciled in the UK, had let the holiday villa to Mr. Owusu. Mr. Owusu sued Mr. Jackson in the English courts for breach of an implied term that the private beach where the accident occurred would be reasonably safe or free from hidden dangers. Mr. Owusu also sued several Jamaican companies in the same action.

Mr. Owusu commenced his claim in the English High Court in October 2000. Mr. Jackson and Jamaican defendants challenged the jurisdiction on the English court on the grounds of private interest factors of \textit{forum non conveniens}. The judge refused to stay the proceedings. The judge referred to the decision of the ECJ in \textit{Group Josi Reinsurance, which} held that whether the jurisdictional rules in the Brussels Regulation applied depended upon whether the defendant had its domicile in a contracting state, and the rules applied to a dispute between a defendant domiciled in a contracting state and a claimant domiciled in a non-contracting state. He concluded that on the basis of the ECJ ruling in \textit{Group Josi}, the decision of the English Court of Appeal in \textit{Re Harrods} was bad law.

The ECJ went on to hold that the \textit{forum non conveniens} doctrine was incompatible with the Brussels Regulations. The regulations and the ECJ's interpretation of it has impacted significantly on the common law rules in relation to jurisdiction by favouring certainty over the flexibility which was built into the common law rules. However, the ECJ declined to answer a second question referred to it, namely whether the application of \textit{forum non conveniens} is ruled out in all circumstances. This leaves open the possibility of the doctrine of \textit{forum non conveniens} still having application in certain

\textsuperscript{56} Case-128/01 (ECJ 1 March 2005) [2005] 2 WLR 942

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circumstances. Cases to which the Brussels Convention or Council Regulation do not apply will be unaffected by the decisions in this case.

In comparing the UK approach to the American one, The UK approach to *forum non conveniens* has never precisely mirrored the US approach, because US courts has granted *forum non conveniens* dismissals whenever, on balance, forum connections were more strongly in favour of a foreign forum, while recent English cases have emphasised the importance of substantive justice for the plaintiff, taking into account the importance of legal aid as well as the general need to ensure that *forum non conveniens* does not result in a denial of access to justice.57

In the USA *forum non conveniens* principles were established under the case of *Gulf Oil Corporation v Gilbert*.58 In the case the Supreme Court established a two-step procedure for deciding whether to dismiss a case on *forum non conveniens* grounds.59 First, a federal court must determine whether an adequate alternative forum exists. If it does, the court must then decide in which forum the litigation would best serve the private interests of the litigations and the public interest of the forum. In international issues, relying on *Piper Aircraft Co v Reyno*,60 the court noted that, in answering a *forum non conveniens* questions, a district court must first determine whether or not the proposed alternative forum is adequate. The court stated that it must then consider the relevant private interests of the parties and public interests factors relating to the current and alternative forum.61

The position of the US courts did not change in the *Bhopal* litigations and the case was dismissed on the ground of *forum non conveniens*. The judge decided that the Indian court was more suitable because private interest factors supported the efficiency of

57 Anderson, Transnational Corporations, (n 30)
58 330 US 501 [1947]
59 Robertson, Forum Non Conveniens, (n 40) and Duval-Major, One-Way Ticket Home. (n 34)
60 454 US 235 [1981]
Indian court. The Indian government and public were very interested in the problem so public interest factors were pointing to Indian venue. Additionally, the judge was convinced the Indian court could handle the case. Thus, the Bhopal decision, like Piper before it, proves that American courts are very reluctant to entertain claims brought by foreign plaintiffs against an American firm.\textsuperscript{62} Indeed, the US approach openly discriminates in favour of local litigants, placing unfair obstacles in the way of foreign plaintiffs wishing to sue US companies in the United States.\textsuperscript{63} Actually, discussing the public interest\textsuperscript{64} in the case, international comity has been used ironically to promote prejudiced outcomes because the USA approach basically depends on the idea that the injuries done by American business to foreign people abroad are not America’s problem. The legal policy problem under \textit{forum non conveniens} principle which is valid for both English and American courts is that US and UK courts are in fear of that there might be a flood of cases to their courts and it would make them more congested. By allowing transnational business to choose legal systems imposing a lower regulatory burden than the United States, US courts have effectively lowered regulatory standards. By refusing to exercise jurisdiction in a case like \textit{Bhopal}, a court effectively allows a US enterprise to avoid US tort liability and encourages other manufacturers to locate plants abroad.\textsuperscript{65}

Assessment Criteria of Forum Non Conveniens Doctrine

The criteria are classified in two segments; private interest factors and public interest factors, which are American, based criteria and rejected by the House of Lords in England.

\textsuperscript{62} Muchlinski PT, ‘the Bhopal Case Controlling Ultra-hazardous Industrial Activities Undertaken By Foreign Investors’ (1987) 50 Modern Law Review 545


\textsuperscript{64} The public interest factors are discussed below. (p 146)
Private Interest Factors

Private interest factors can be classified as factors related to procedural problems in litigations and issues directly related to the case. In the evaluation of private interest issues, the courts have often concentrated on the location of evidence and witnesses, enforceability of witness summons, and where the respective parties reside. USA courts also consider the possibility of enforcing a judgment. Moreover, English courts have given weight to practical considerations that are important for proper judgments such as the availability of a legal aid, contingency fee agreements and language barrier problems, which question the adequacy of the foreign forum. Shortly, they ask if substantive justice could be achieved in an alternative forum by questioning the adequacy of the foreign forum and diversity of proceedings.

Evidences and Witnesses

In the tort cases against MNEs, evidence and witnesses are usually in the host countries where the subsidiaries perform their activities so overseas witnesses are likely to be more common in these cases and this will weigh against the home country forum. If documents in the possession of the overseas subsidiary are likely to be relevant, the parent company will usually have power to require their production. This argument can however be advanced in a defendant's favour where documents are in the possession of some other party overseas (e.g. a Government body) which is unlikely to volunteer the documents. In those circumstances a court order will be necessary, but an order from an English court would probably be unenforceable; this is therefore a factor in favour of the

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65 Robertson, Forum Non Conveniens, (n 40) and Dunham DF and Gladbach EF 'Forum Non Conveniens and the Foreign Plaintiffs in the 1990s' (1998-1999) 24 Brook. J. Int’l. L. 665 and Prince, Bhopal, (n 63)
66 Dunham and Gladbach, Forum Non Conveniens, (n 65)
67 Dunham and Gladbach, Forum Non Conveniens, (n 65)
court declining jurisdiction. However, many issues are likely to be resolved by means of expert evidence, and this will reduce the need to call witnesses of fact and lift the balance back in favour of the English forum. Under the problem of the enforceability of witness summons it is important to consider whether or not the foreign country is a party to the 1970 Hague Convention on the Taking Evidence Abroad in Civil and Commercial Matters. If so, subpoenas issued out of the English High Court will be enforceable in that jurisdiction and this will minimise the impact of any evidence advanced by the defendants as to the existence of relevant witnesses in the foreign jurisdiction. Even if the Hague Convention cannot be relied upon, there is also the possibility of obtaining depositions from foreign witnesses by means of letters of request.

It should not be ignored that the actions are against groups of companies for tort of subsidiaries so courts have to check all possible decision-taking procedures or transactions in the group and listen to managers and other administrative workers of the companies. Under new developments in technological and communication of the operating companies, the documents or all the information that are needed can be easily produced because there is already very well developed flows of information amongst companies in the group. Thus, the horizontal structure makes it impossible to point another jurisdiction as more appropriate in terms of evidence and witnesses. Therefore, it is really difficult to decide that host countries are more suitable due to availability of evidence, and even if they are, this suitability cannot be distinct and clear any more. Additionally, the consideration of likelihood of finding expert witnesses makes the forum of developed countries more appropriate.

70 Meeran, Process Liability, (n 68)
71 Detailed discussion is made at chapter 2.
Enforcement

Courts have no inherent power to enforce judgments made by foreign courts against defendants, but courts might consider the enforcement rules as a significant factor.\textsuperscript{72} If there is no possibility of enforcing a judgment against the defendant company, a stay should not be given. In \textit{Adams v Cape industries} the English court of Appeal held that the Texas judgment was not enforceable against \textit{Cape} because it had not been present in Texas at the relevant time and the presence of its subsidiary could not constitute the necessary presence by \textit{Cape} itself. Therefore, because of the risk of non-enforcement the defendant should be forced to guarantee to obey the foreign forum courts' decision and pay the awards, as applied in the \textit{Bhopal} case. This solution may not be as effective as hearing the case in the parent companies states forum but at least it can prevent the plaintiffs giving up the case because of enforcement problems.

In case \textit{forum non conveniens} is applied in cases brought in home countries, there will be problems of reverse enforcement. According to general principles only subsidiaries are domiciled in host countries so if there is a finding against parent companies, the enforcement problem will occur because of the non-domicile status of parent companies in host states. This will create the problem that when the proceeding is finalised in host states' the plaintiffs will have to look for possible enforcement issues in home countries. If there is any enforcement agreement between the involved states the enforcement must not be considered as criteria for assessing the \textit{forum non conveniens} argument since both rulings will be treated in the same way. If there is no enforcement agreement, the enforcement problem will be two sided whichever court decides there will be problem of enforcement. Moreover, under a horizontal organizational structure involvements of more than one entity in the groups in tort will be more likely and these entities might be in different jurisdictions. In this case in whichever jurisdiction the case is pursued, there will be a question of enforcement for the other entities since they are

\textsuperscript{72} Dunham and Gladbach, Forum Non Conveniens, (n 65)

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domiciled in other jurisdictions. Thus, the application of *forum non conveniens* will be more problematic.

**Efficiency of the Alternative forum**

American and English courts additionally evaluate the efficiency of alternative courts. If they come to the conclusion that the alternative courts are efficient enough to hear the case they grant a stay. They have no certain criteria for the evaluation since the assessment criteria used in past cases are vague. Some issues concerning the adequacy of the Indian forum was raised by the plaintiffs in *Bhopal* case; first, the plaintiffs argued that the Indian forum was inadequate because it lacked the innovation necessary to deal with litigation as complex as the *Bhopal* case. In dismissing this argument, the court relied on the testimony of the defendant’s expert to show that the Indian judiciary had responded in the past by creating complex legal problems. Second, the plaintiffs argued that the Indian forum was subject to widespread delays. The court responded it could happen in the USA as well. Third, the court found unpersuasive the plaintiffs’ further argument that substantive Indian law is incapable of handling the complexity of the *Bhopal* litigation. The plaintiffs’ fourth argument focused on whether Indian procedural law would prevent the litigants from receiving an adequate trial. The court responded with concerns that India’s discovery procedures would not be as expansive as those of the United States but US court though it was efficient enough to handle the case.

In the UK, in the *Cape* case the House of Lords did not find South African courts experienced enough to handle a group action case. These discretionary evaluation criteria make the future of cases dependent on the alternative forum’s country; if a country has a developed law system they grant the stay, if not they do not. One of the specific findings of Sir John Wood in the *Connelly* case was that “whilst the plaintiff had obtained legal aid to sue RTZ in England, the chances of him securing funding to litigate in Namibia were remote”. Additionally, the legal aid problem was one of the main
arguments in the Lubbe v Cape case and it was discussed very broadly by the parties. It is accepted that there is no legal aid available in South Africa for personal injuries. The Court of Appeal decided that unavailability of legal aid is not enough to remove the stay. Nevertheless, the House of Lords revised the decision as they considered that legal aid was very important for the future of the case and therefore, with the absence of any contingency fee agreement, it might prevent justice being achieved. This makes MNEs’ tort liability cases dependant on where the tort action occurs and thus it is impossible to predict the result of future cases.

Under the harsh conditions of forum non conveniens, in the UK, the plaintiffs’ last argument in the case is human rights issues under which they claim they cannot get substantive justice in the alternative forum so the dismissal of a case under forum non conveniens violates article 6 of the European Convention on Human Rights, which regulates entitlement to a fair hearing. These claims have not been taken to the European Court Human Rights. In a possible situation if the issue is brought to the European Court of Human Rights, I do not think the court will decide in favour of plaintiffs since in forum non conveniens cases the courts claim that they are not rejecting the cases and the alternative forum is available to reach a substantive judgement. Moreover, recent Owusu v Jackson decision of ECJ will reduce possible success in this matter.

Under the private interest factors each practical argument might be raised in any case. The claims that American and English courts base their arguments on can be converted to prove that English and American forums are appropriate as well home countries because MNEs perform their business under very complicated business structures.73 Thus, all private interest factors may point to a home countries forum as well. Under the complicated economic and managerial structure of business it is impossible to prove other countries’ forums are distinctly and clearly more appropriate. Most of the documents can easily be reachable any country in which any component of the MNEs is domiciled. The system of information exchange is also applicable for courts; in case of requirements any witness or any documents can be contacted in any

73 Detailed discussion is made at chapter 2.
state as happens in case of business relations. More importantly, in tort claims, the evaluation of decision taking and the components of tort action multi-jurisdictional examination is a requirement. The modern structure considers MNEs not as single decision making centres; rather each entity can make independent decisions under common group policies. Thus, any tort committed by one subsidiary under a group will have complex roots in the process that led to this incident. Wherever the case is heard the same examination procedure will be gone through. Thus, dismissing the case on the ground of *forum non conveniens* does not change this fact. If the aim is to achieve substantive judgement, *forum non conveniens* is definitely not a tool to do so.

Public Interest Factors

Public interest factors are applied by American courts to prevent flows of cases to the US. American courts examine the public interest factor in three parts; the public policy aspect of the dispute, the choice of law issue and the administrative burden issues. The main justification for the application of public interest factors is that they should not require American citizens to bear the cost of jury service and court expenses when they had little connection to the subject matter of the case. In the *Bhopal* case American courts decided that Indian courts are more interested in the problem and thus are more appropriate. Moreover, the nature of law also pointed at the Indian law. During the case, for example, the district court focused on the Indian government’s extensive regulation of its country’s chemical industry as evidence indicating that the Indian government had a strong interest in the dispute, and therefore supporting a *forum non conveniens* dismissal. Most important public interest factors in the courts’ decisions were the local interest factors in the action and application of foreign law but strangely enough the Indian government itself initially sued in the United States District Court for the

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74 Birnbaum and Dunham, Foreign Plaintiff, (n 39)
75 Dunham and Gladbach, Forum Non Conveniens, (n 65)
Southern District of New York on behalf of all individual victims, suggesting that the government was not opposed to the US judicial system crafting a solution to a problem that arose in India.\textsuperscript{76} The Chief Justice of the Supreme Court of India said: \textit{"in my opinion that these cases must be pursued in the United States... it is the only hope these unfortunate people have."}\textsuperscript{77}

Therefore, assessing public policy issues is very complex. It may be true that the Indian government and public were interested in the problem but on the other hand, the American public was also interested in the problem because a chemical industry plant is an important public issue in the USA. In addition, the company had the same kinds of plant and chemical foundations in the USA that needed to be regulated strictly. This means that the interest of public is always two sided, citizens' interest and public administrative bodies' interest.

In the light of global developments and activities of any MNE, any activities and tort actions of MNEs are discussed at a worldwide level. For example, recent asbestos related liability claims and pharmaceutical liability cases attract attention from all over the world at an administrative level or at a public level. In the Bhopal case as well, the worldwide public attention has been significant. Persons from the UK were never part of the Bhopal disaster but the involvement of NGOs, media and even at an administrative level were very high.\textsuperscript{78} Moreover, the globalisation of MNEs as well as economic institutions in the world brings more globalised media coverage. People all over the world have a chance to follow news worldwide. Even small accidents can be viewed by millions of people. The easy use of the Internet makes information exchanges very fast and wide. People are organized according to their concerns and campaigners create public policy not only at the domestic but also at a global level. The issue of the liability

\textsuperscript{76} Muchlinski, the Bhopal Case (n 62) and Miller Laurel E, 'Forum Non Conveniens and State Control of Foreign Plaintiff Access to U. S. Courts in International Tort Actions' (1991) 58 U. Chi. L. Rev. 1369

\textsuperscript{77} Cited at Robertson D, 'the Federal Doctrine of Forum Non Conveniens' (1994) 29 Texas ILJ 353

\textsuperscript{78} For example BBC has a whole section on Bhopal tragedy available at http://news.bbc.co.uk/1/hi/programmes/bhopal/default.stm. Moreover, UK governments' Health and Safety Commission prepares its control major accident hazards by giving examples form Bhopal Tragedy, available at http://www.hse.gov.uk/comah/aaragtech/caseuncarbide84.htm.
of MNEs is definitely one of the most discussed global problems. Consequently, all people either from a developed country or a developing country have an interest in the issues. Thus, there are many NGOs contributing to the formation of public policies at a local and global level. Moreover, the governments neither in developed countries nor in developing countries have the luxury to ignore these discussions. Thus, the issue is always a matter of public policy in any country but from different perspectives.

Therefore, one interpretation of American courts’ decisions shows that the basic reason for dismissing cases on the ground of forum non conveniens is to keep disputes against American MNEs out of American courts. Thus, in the Lubbe v Cape79 the House of Lords did not find it suitable to apply public interest factors. It is a truthful interpretation of the public policy issues because public policy is not a legal issue, so determining the future of cases on the ground of public interest factors could make the courts involved in policy that would have a very negative effect on credibility of the courts.

Criticism of Forum Non Conveniens Doctrine

In the cases that we have mentioned, on one side, there is a big MNE and on the other side there are people from less developed countries, who cannot even pay the court expenses without legal aid. These poor people choose the forum of the parent company’s country because in their own country the punitive awards are very small, the quality of judgment is poor and they cannot even find lawyers to represent them. On the other side, there are powerful MNEs some of which have bigger assets than most of the less developed countries have. This power may give them a chance to interfere in the courts in the plaintiffs’ countries. Therefore, these legal barriers may prevent plaintiffs from

79 Lubbe v Cape Plc [2000] 1 W.L.R. 1545
recovery in their home country. Thus, after the dismissal of cases, many plaintiffs lose their wish to follow the cases since they have lost their lawyers, money and courage. Therefore, most of the cases are abandoned, and those that are not are mostly settled for less than their estimated value. Thus, MNEs try hard to shift cases to the plaintiffs' forum in order to stay away from high punitive awards. Furthermore, even if the plaintiffs win the cases they will become engaged with enforcement problems; the plaintiffs' countries' decisions may not be enforced, which may make all their efforts useless.

This criticism sometimes finds supporter from the judiciary; Justice Doggett in the case of *Dow Chemical Company v Castro Alfaro* "The doctrine of forum non conveniens is obsolete in a world in which markets are global and in which ecologists have documented the delicate balance of all life on this planet.... (It) enables corporations to evade legal control merely because they are transnational.... In the absence of meaningful tort liability in the United States for their actions, some multinational corporations will continue to operate without adequate regard for the human and environmental costs of their actions. This result cannot be allowed to repeat itself for decades to come. As a matter of law and of public policy, the doctrine of forum non conveniens should be abolished".

Accordingly, the *forum non conveniens* is a complete waste of time and plaintiffs' resources and both the *Bhopal* and the *Cape Industries* cases amply demonstrate how the *forum non conveniens* can hold back speedy resolutions of disputes, keeping claimants locked into a process that focuses on determining the proper forum for the action. Plaintiffs and defendants just apply to court to, in the words of Prof. Robertson "litigate in order to determine where they shall litigate".

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80 Duval-Major, One-Way Ticket Home, (n 34)
81 Robertson, Forum Non Conveniens, (n 40)
82 Ward, Corporate Accountability, (n 32)
83 *Dow Chemical Company v Castro Alfaro* 786 S.W.2d 674 (Supreme Court of Texas 1990)
84 Ward, Corporate Accountability, (n 32)
In both the English and American law systems the principles of *forum non conveniens* is very broad and vaguely interpreted and gives judges nearly unlimited discretion rights. Although there have been attempts to establish basic principles, they cannot embrace all possible situations. Consequently this vague situation just helps MNEs escape from liability. The adoption of the most suitable forum version of the *forum non conveniens* doctrine has made it impossible to predict the outcome of a jurisdictional issue that would have been easy to forecast without the principle. 85

The multinational business, as it is obvious by its name, considers every each business relations at the same level. 86 For them the classification of people on the basis of citizenship is over. They make profit from their activities from all over the world and distribute these profits to their company's shareholders mostly resident in home countries. However, the judges know that courts are supported by taxpayers so English and American courts think that since their citizens pay tax for a better quality jurisdiction, courts must not be busy with claims on non-citizens. It is true that citizens pay taxes but the real money comes from the overseas activities of MNEs. The Shell Company declared a profit more than £12.5 billion in 2006 87 and it is not difficult to guess where this money came from; from Nigeria, Indonesia, Middle East and Africa, basically all over the world. This profit is distributed to shareholders mostly resident in the UK and these shareholders pay taxes.

Courts also claim that they do not dismiss the cases but just transfer them to another forum. However, in practice there is almost no difference between dismissing cases and transferring them to other forums, because obtaining your right after the stay is almost impossible. More importantly, as Professor Robertson explains, a court in New York cannot transfer a case to India, it can only dismiss; "These astonishing references to transfer in the international forum non conveniens context are part of a disguised vocabulary whereby the true effects of forum non conveniens dismissal are masked ... in

85 Robertson, Forum Non Conveniens, (n 40)
86 Detailed discussion is made at Chapter 2.
87 See www.shell.com.
the real world, everyone knows that international plaintiffs who suffer forum non conveniens dismissals in the United states are typically unable to go forward in the hypothesized foreign forum". 88

Moreover, the modern context of convenience cannot be interpreted in the same way as that of decades ago since many advances in technology and transportation have taken place. 89 The modern concept of organisational structure can never point out any particular jurisdiction clearly. 90 It is a fact that a jurisdiction can be convenient in some aspects but none of the alternative jurisdictions for MNEs' tort litigation will be clearly and distinctly more appropriate. Characteristics of the modern managerial and organisational structure of MNEs suggest that the distinction between member organisations is not as clear as it used to be. This fact plays an important role when deciding the convenient forum in MNEs' torts since under complex horizontal organisation it is almost impossible to point out one single forum under which decisions were taken or a tort has been committed. The decision making process is now complicated since it includes parent, subsidiary, other operational subsidiaries and basically it is based on group policy.

For example, in a hypothetical tort committed by a petroleum company in a less developed country, more particularly where there was a problem in their exploring plant and as consequence the petroleum polluted rivers and caused huge environmental damage and impact on the life of local people. In this case the tort is committed in the subsidiary's forum. However, the process of building and operating the plant involves the parent as a policy determinant as well as a negotiation body before establishing the local subsidiary. Moreover, it involves research and technology companies in the groups as basic determinants of operational technology. It may also involve construction department and thus another subsidiary since they were the one responsible for building in the plant side. Moreover, another important aspect of such projects, financing, is

88 Robertson, Forum Non Conveniens, (n 40)
89 Dunham and Gladbach, Forum Non Conveniens, (n 65)
90 Detailed discussion is at chapter 2.
usually dealt with by financing department. In short, the process of building a plant and operating involves many different divisions and companies in a MNE with each one having different responsibility in different time period.

If defendants argue that there the forum of subsidiary is more convenient, the private interest factors will point out many different forums. Evidence can be found in different jurisdictions, for example the original decisions of investments were made in headquarters, and the corporations responsible for the technology might be in other jurisdictions. Witnesses and responsible people on the process will be scattered around different forums as well. Expert witnesses will be available mostly in the forum of the parent. In short, the concept of convenience does not suit into the modern structure of MNEs under which it is almost impossible to spot a more suitable forum. Thus, the *forum non conveniens* doctrine has no practical applicability. And more importantly, the issue of searching for convenience must not prevent the search for justice as happened in *Cape* cases and *Connolly* cases.

All these explanations prove that as an empirical matter, *forum non conveniens* decisions invariably determine the outcomes of international tort cases and thus have an effect on substantive law. Consequently, the doctrine prevents the common law from reaching a conclusion in determining tort liability of MNEs. Considering these realities together with the non suitability of *forum non conveniens* principle to modern MNE concept, we should discuss the alternatives and suggestions.

**Alternatives and Suggestions to *Forum Non Conveniens***

If torts committed by MNEs discriminate against people living in the jurisdictions of subsidiary companies, a quest to search for an appropriate solution must start. One straightforward answer is to amend the rules of private international law that
discriminate against foreign litigants. The movement towards a global judgment convention in The Hague conference on Private International Law may provide part of the answer here, but even if that effort results in a viable treaty that is widely ratified by states, it may still contain room for the application of the *forum non conveniens* doctrine.\(^92\) Under these conditions, other solutions could be achieved in common law, because as the *forum non conveniens* doctrine is a creature of equity, and might be abolished.

**Conditional Forum Non Conveniens**

In the *Bhopal* case, judge Keenan decided that India had an adequate forum and the capability to deal with the case, but imposed some conditions for the defendant. The subsequent conditions were laid down; 1- Union Carbide must consent to submit the jurisdiction of the courts of India and shall continue to waive defences based upon the statute of limitations 2- Union Carbide must agree to satisfy judgment rendered by an Indian court, and if applicable, upheld by an appellate court in that country, where such judgment and affirmanence conform with minimal requirements of due process 3- Union Carbide must be subject to discovery under the model of the US Federal Rules of Civil procedure after an appropriate demand by plaintiffs.\(^93\) The American court tried to seem fair when imposing conditions for the defendant. However, imposing conditions for the defendants cannot provide consistent solutions for the problems because each case has its own specific conditions. As it has been apparently proved in the Bhopal case, the dispute has not been solved yet in satisfactory way for victims.\(^94\) More importantly, these conditions cannot bring the expected level of protection for the plaintiffs and thus

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91 Miller, Forum Non Conveniens, (n 76)
92 Anderson, Transnational Corporations, (n 30)
93 Abraham CM and Abraham S, 'The Bhopal Case And The Development Of Environmental Law In India' (1991) 40 ICLQ 334
cannot help to establish MNEs' tort liability. The conditions were imposed because the court wanted to relieve public concern and protest in the US. However, the facts seem to contradict the American courts' professed belief that conditional dismissal for *forum non conveniens* is not a decision going to the character and result of the controversy; as Professor Robertson indicated pretending that such dismissals are not outcome-determinative is a rather fantastic fiction. 95

**Judiciary and Judicial Procedure Act in the USA (28 U.S.C. § 1404(A))**

When there is problem of imposing conditions in *forum non conveniens* dismissal and also impossibility of transferring a case from one forum to another forum, in American federal law can be considered as an alternative example to *forum non conveniens* dismissal. After enactment of the new procedural law of 28 USC 1404 (A) enacted in 1948, *forum non conveniens* problems amongst American district courts lost their applicability. The law provides that "for the convenience of parties and witnesses, in the interests of justice, a district court may transfer any civil action to any other district or division where it might have been brought". 96 Courts have been given more discretion to transfer under the Act than they had to dismiss on grounds of *forum non conveniens*. Moreover, the change of venue does not influence the law applied to the case and is therefore only a procedural plan that will not alter outcome of disputes. 97 It is a good solution for domestic forum problems in the US but application of the same rules could be too utopian on an international level. Judge Marshall's opinion for the majority in *Piper* noted that the development of the section 1404(a) transfer rules were drafted 'in accordance with the doctrine of *forum non conveniens*,' but that the district court's discretion to dismiss is in fact more substantial under the transfer statute than under the

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94 For more information, see [www.bhopal.net](http://www.bhopal.net)
95 Robertson, Forum Non Conveniens, (n 40)
96 Robertson, Forum Non Conveniens, (n 40)
97 Miller, Forum Non Conveniens (n 76)
common law doctrine. Thus, the relocation of a case within the federal system is more flexible than its dismissal for purposes of litigation outside the United States.

At least in theory, transferring a case from one federal court to another does not need to seriously disrupt its progress because the case does not have to be refiled; there will be no problem with the relevant statute of limitations having expired while the case was pending in the first court. However, in transnational civil litigation, it is not possible to transfer cases to another state. The courts can only dismiss the cases on the basis of forum non conveniens, which will encounter the same problems. Moreover, the aim of plaintiffs by starting their legal actions in America is to escape the inefficiency of legal procedural systems in the forum state of subsidiary. Thus, even the successful transfer of the case to alternative forum does not provide justifiable solutions.

Australian Approach to Forum Non Conveniens

In the UK and the US the courts apply the most suitable forum approach in forum non conveniens discussions. Accordingly, in the UK the courts dismiss the case whenever there is an alternative forum clearly and distinctly more appropriate and similarly in the US whenever the balance of convenience points out to the alternative forum. However, Australian case law takes a different approach, which is clearly in favour of tort victims in comparison to English and American approaches. The key element in Australia’s approach is its maintenance of the notion that a forum non conveniens stay should not be granted unless the choice of forum is clearly oppressive or difficult for the defendant. In Voth v. Manildra Flour Mills, the High Court affirmed a test, declaring that an Australian court would need to be ‘clearly inappropriate’ before a stay on forum non

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98 Dunham and Gladbach, Forum Non Conveniens, (n 65)
99 Robertson, Forum Non Conveniens, (n 40)
100 (1990) 171 CLR 538

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grounds could be granted.\textsuperscript{101} This sets a specific standard against which requests for such stays can be measured; one, moreover, which is rightly difficult for a local defendant to meet.\textsuperscript{102} The Australian doctrine has retained the aim of protecting the defendant from harassment caused by a clearly inappropriate choice of forum by the plaintiff. Instead it uses the very reason foreign plaintiffs would have for taking a matter to court which is their great interest in the case as the main ground for rejecting a hearing.\textsuperscript{103} The great benefit of such an approach is its avoidance of balancing of the US’s balance of foreign forum and UK most suitable forum doctrine, under which a foreign plaintiff is at an immediate disadvantage. On the basis of the Bhopal case, adoption of the Australian \textit{forum non conveniens} approach by US courts would have been more in keeping with the United States’ global responsibilities, both in terms of foreign citizens being able to recover proper compensation from MNEs, and in terms of the legal standards that US corporations should be required to observe in their overseas operations.\textsuperscript{104} Therefore, the Australian approach represents a more acceptable solution to the \textit{forum non conveniens} doctrine but the risk of dismissal is always present under this approach as well. It should not be forgotten that, even in the Australian approach the battle to establish forum would be causing long time losses.

\textbf{Brussels and Lugano Conventions}

In the EU, a coordinated system for deciding issues of jurisdiction already existed under the Brussels Convention on Jurisdiction and Enforcement of Judgments in Civil and

\begin{itemize}
  \item[{101}] Prince, Bhopal, (n 63)
  \item[{103}] Prince, Bhopal, (n 63)
  \item[{104}] Prince, Bhopal, (n 63)
\end{itemize}
Commercial Matters. It establishes (article 2) a general principle that defendants can be sued in the courts of the EU member state where they are domiciled. The result of an interpretation of the article will be that between member states, plaintiffs can sue defendants in the defendants' domiciles ignoring other probable domiciles. Consequently, courts cannot apply the *forum non conveniens* doctrine for plaintiffs from member states because under the Brussels Convention there is no place for broad jurisdiction-declining discretion and it seems to operate quite well without it. The Lugano Convention is not different from the Brussels Convention in the principles applied; it just made the applicability of Brussels Convention principles broader by including EFTA countries. Therefore, the more countries sign these Conventions, the narrower the applicability of *forum non conveniens* will be.

In brief, the Brussels and Lugano Conventions provide the most developed jurisdiction regulation. Both Conventions prohibit the dismissal of the cases on the ground of the *forum non conveniens* doctrine, so they have created safe and predictable solutions for plaintiffs exposed to tort actions of subsidiaries of MNEs. However, the countries in which the conventions are applied are limited and basically developed countries. Thus, there are still problems in application of the doctrine and even though its application is fundamentally reduced in the UK by ECJ decisions, American courts still widely apply the doctrine of *forum non conveniens*.

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106 Lugano Convention of 16 September 1988 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters

The Alien Tort Claims Act (ATCA)\textsuperscript{108}

The Alien Tort Claims Act allows foreigners to bring a civil suit in a US District level courts for a crime committed anywhere in the world by an individual, government, or corporation that violates the law of nations or a treaty of the United States. This Act grants the district courts competence to hear tort claims from non-Americans who have been a victim of a violation of a norm of ‘the law of nations’ or a treaty to which the United States is party, no matter where the violation has occurred.\textsuperscript{109} Therefore, the ATCA litigation has drawn considerable attention from academics, and is seen as an attractive option to solve jurisdictional problems in MNE torts because it provides access to US courts.

The ATCA was originally created for use against pirates, but it was left inactive and forgotten until 1980 when it was rediscovered and put to use by lawyers in the landmark case of\textit{Filartiga v. Peña-Irala}.\textsuperscript{110} Using the ATCA, two Paraguayan family members brought suit against a former Paraguayan state official who had committed acts of torture against a member of their family. They won a guilty verdict and were rewarded a significant monetary amount. Moreover, the act gained a new importance when the Second Circuit held in\textit{Kadic v. Karadzic}\textsuperscript{111} that the ATCA could be used against private individuals.\textsuperscript{112} Karadzic’s clear expansion of the capacity of human rights claims under the ATCA to cover private non-state actors facilitated applying the same reasoning to private non-state actors in corporate form. In the cases that so far apply the Karadzic rationale directly against corporate defendants, the results indicate

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\textsuperscript{108} 28 U.S.C. \& 1350


\textsuperscript{110} 630 F.2d 876 (2d Cir. 1980)

\textsuperscript{111} 70 F. 3d 232 (2d Cir. 1995)
\end{flushleft}
that American courts are willing to consider claims based on violations of international human rights laws against MNEs.\textsuperscript{113} This standing was recently confirmed by Doe I v. Unocal Corp\textsuperscript{114} which clarified that the ATCA cannot only be invoked against state actors, state officials and private actors for acts but also against private actors for purely private acts.\textsuperscript{115}

Accordingly, corporations can be held liable for violations committed 'in concert with' government officials. This principle of private corporate liability under the ATCA has been upheld in a handful of preliminary decisions, although some have been dismissed on other grounds and none has yet resulted in a final judgment. In Doe I v. Unocal Corp for example, the district court found that a corporation can be held liable for private acts of slavery and forced labour because the international law prohibitions apply to all actors. Furthermore, for MNEs tracking the development of the Unocal case, the use of an 'aiding and abetting' test in comparison with one of 'state action' to define private liability under the ATCA, is important because it potentially lowers the bar significantly for aliens to sue MNEs in US courts.\textsuperscript{116} Similarly, in Beanal v. Freeport-McMoRan,\textsuperscript{117} the district court found that a private corporation could be held liable for genocide, which by definition is barred whether committed by 'public officials or private individuals'.\textsuperscript{118}

According to the case law, which has some settled criteria; a successful claim under ATCA must present three elements: 1- an alien sues 2- for a tort 3- committed in violation of the law of nations. The third presents the most analytical difficulties because

\begin{itemize}
\item \textsuperscript{112} Zia-Zarifi Saman, 'Suing Multinational Corporations in the U.S. for Violating International Law' (1999-2000) 4 UCLA J. Int'l L. & Foreign Aff. 81
\item \textsuperscript{113} Zia-Zarifi, Suing Multinational, (n 112)
\item \textsuperscript{114} 110 F. Supp. 2d 1294 (C.D. Ca. 2000)
\item \textsuperscript{115} Wouters, Smet and Ryngaert, Tort Claims Against, (n 109)
\item \textsuperscript{117} 969 F.Supp. 362 (EDLa. 1997)
\end{itemize}
it forces American courts to identify customary international law and treaties. Thus, only a limited number of recognised, serious human rights crimes such as torture or genocide can, in practice, serve as the basis of an ATCA suit rather than catching all civil liability claims of aliens.

Thus, the provision is unusual in that it requires plaintiffs to find their cause of action in international law rather than the national law of either the US or the state where the injury occurred. In practice, this means that the grounds for bringing a tort claim under ATCA are very narrow, and have been restricted mainly to serious violations of human rights. The latter form of individual liability that exists in the lack of state action is strictly limited to ‘offences recognised by the community of nations as of universal concern’. Moreover, the international law rules must be specific, universal and obligatory. Consequently, there is a huge limitation burden on plaintiffs to establish jurisdiction over companies. This heavy burden is results of the more complex early legal analysis required in establishing subject matter jurisdiction in ATCA cases, since plaintiffs relying on the ATCA must identify enforceable and universal international norms and properly claim their violation by the defendant.

Moreover, there are significant procedural hurdles to be overcome in bringing ATCA cases- including not only forum non conveniens, but also arguments regarding the act of state doctrine and sovereign immunity. Similar problems may arise in other jurisdictions, such as the UK, which do not have an equivalent of the ATCA, but may

119 Zia-Zarifi, Suing Multinational, (n 112)
121 Khalil, The Alien Tort Claims Act ( n 116)
122 Wouters, Smet and Ryngaert, Tort Claims Against (n 109)
123 Zia-Zarifi, Suing Multinational, (n 112)
apply the Act of State doctrine and sovereign immunity.\textsuperscript{124} In summary, the possible obstacles in ATCA litigation can be examined under following titles.

1-As discussed earlier, the category of torts that can be brought under the ATCA is limited within the scope of international law. An examination of MNEs' torts will show that most of the torts that are committed by MNEs never meet the criteria of being against international law. Thus, they will never be able to taken to court under ATCA claims. For example, the tort committed in the Bhopal case, or asbestos related claims may never fall in scope of ATCA litigation. Even the cases that have international aspects have been dismissed; in litigation against Freeport, plaintiffs claimed that defendant violated at least three international environmental law principles 1- polluter pays 2- the precautionary principle 3- the proximity principle.\textsuperscript{125} However, the court held that even if it is true, it did not amount to violation of the law of nations because the three norms were not universally binding and not sufficiently definable.\textsuperscript{126} These cases show that American courts do not believe international environmental law has achieved the level of universality and specificity necessary for supporting ATCA jurisdiction.\textsuperscript{127} Therefore, these interpretations of international law only protect negative human rights, which do not cover most part of the tort claims since the torts are determined according to national laws. Thus, most tort actions will never be able to brought under ATCA. Moreover, successful ATCA litigation requires state action in the tort process. In many ways international law analysis affirmed in Kadic matches the parent-subsidiary joint action analysis in that it involves assigning unlawful actions to an entity (the state) that only indirectly caused the harm. The joint action test requires either a conspiracy or

\textsuperscript{124} Anderson, Transnational Corporations, (n 30)
\textsuperscript{125} In the same way, the court in Flores v. S. Peru Copper Corp 343 F. 3d 140 (2d Cir. 2003) held that it lacked subject matter jurisdiction over the Peruvians' environmental claims styled as claims for life and health. Again a recent case, Sosa v. Alvarez Machain (124 S. Ct. 2739, 2766 n.20 (2004)) the court decided that the door for ATCA claims is still ajar subject to vigilant door-keeping, and thus open to narrow class of international laws today.
\textsuperscript{126} Zia-Zarifi, Suing Multinational, (n 112)
\textsuperscript{127} Zia-Zarifi, Suing Multinational, (n 112)
wilful participation with the state actor, or a substantial degree of cooperative action between the state and private actors.\textsuperscript{128}

2- ATCA requires that, as a company to be tried, the corporations must have ‘sufficient contact’ in the US for an American court to have jurisdiction to judge them. The defendant must have minimum contact and the contact must be systematic and continuous.\textsuperscript{129} This might prevent most of the MNEs from other jurisdictions being brought into the US courts. It is argued that where a parent company is not US-based, US courts had no jurisdiction, for instance over Total, a French company which is a partner in the same joint venture as Unocal in Burma. This argument was raised in the case of the murder of Nigerian activist Ken Saro-Wiwa and others brought in New York by their families, where Shell’s argument is that it bears no responsibility on the grounds that it does not exist in the USA. The court response to this argument was interesting; foreign corporations are subject to suit when doing business in the United States, even if such contacts are a small part of their worldwide operations. As a result, US courts upheld personal jurisdiction over Royal Dutch Petroleum Company and Shell Transport and Trading Company\textsuperscript{130}, two foreign corporations, based on the operations of their investor relation’s offices in New York.\textsuperscript{131} Indeed, corporate liability greatly expands the practical sweep of ATCA litigation, as it is less likely to be limited by practical questions of personal jurisdiction: MNEs are more likely to be present in the United States for personal jurisdiction purposes than are individual performers.\textsuperscript{132} This is very important since it establishes jurisdiction over companies even they are not domiciled in the US. More importantly, this decision can easily be interpreted in a way that the

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\textsuperscript{128} Londis L, ‘The Corporate Face of the Alien Tort Claims Act How an Old Statute Mandates a New Understanding of Global Interdependence’ (2005) 57 Me. L. Rev. 141
\textsuperscript{130} Wiwa v. Royal Dutch Petroleum Co. 226 F 3d 88 2d Cir 2000
\textsuperscript{131} Stephens, Corporate Liability, (n 118)
existence of subsidiary in the jurisdiction must be sufficient to establish jurisdiction over all components of MNEs.

3- The issue whether ATCA abolishes the obstacles that current law creates must be examined as well. The structure of company law and the organisation of MNEs still prevent most of the cases being tried in home countries. In ATCA cases, in accordance with practice, plaintiffs aim at parent corporations. Thus, in order to assert jurisdiction over a foreign parent corporation, plaintiffs must show that the parent either directly conducted business within the jurisdiction, or that the parent conducted business indirectly through subsidiaries that acted as the parent’s *alter ego* or agent, and that these business contacts were continuous and systematic enough to make the court’s assertion of jurisdiction reasonable under constitutional and international standards. This means the parent must be directly connected to a tort claim in order to be held liable, which leads us to situations very similar condition to *veil piercing*.

For example, in a recent ATCA case the court denied plaintiff’s claims that the subsidiary was *alter ego* of the parent.

4- Another requirement for a successful ATCA claim is that plaintiffs must be aliens in order to bring suit under the ATCA, and will usually be a foreigner thus, being subject to *forum non conveniens* application is always possible since ATCA does not abolish the applicability of the principle. In *Wiwa v Shell*, American court dismissed the case on the ground of available English jurisdiction although plaintiffs claim they cannot bring the case under English law. The doctrine of *forum non conveniens* and applicable ATCA guarantee that only a very few cases appear in American courts. In the first cases though the *forum non conveniens* was consistently rejected in most ATCA

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133 Londis, The Corporate Face, (n 128)
134 Zia-Zarifi, Suing Multinational, (n 112)
135 Detailed discussion is made at chapter 4.
137 Zia-Zarifi, Suing Multinational, (n 112)
138 Zia-Zarifi, Suing Multinational, (n 112)
cases but it was applied in the case of *Texaco v Aguinda.* This was ultimately dismissed on *forum non conveniens* grounds. This case was involved environmental claims against Texaco for its operations in Ecuador. Thus, the risk of being dismissed in ATCA cases still exists so the encouraging effect of ATCA cases has been turned into useless litigation that cannot bring another option for the most common situations. Accordingly, *forum non conveniens* has become more effective as a defence given that human rights liability in the wake of *Flartiga* has expanded beyond violations of fundamental human rights by government officials, to violations by corporate entities and private individuals who conspire with or act as agents of oppressive governments. Some example cases which were rejected on *forum non conveniens* are; *Bowoto v Chevron Texaco, Saro-Wiwa v Shell, Torres v. S. Peru Copper Corp* *Aguinda v. Texaco.*

5- In case of a final judgment, the question arises why a foreign court should enforce the decisions of American courts to punish their corporations and citizens. They will not be very eager to enforce the decisions especially if these decisions are involving discussion of foreign state sovereignty.

In conclusion, MNEs, unlike the other defendants in ATCA lawsuits, have the motivation, money and experience to litigate fully all jurisdictional limits and advantages of corporate structure available to them to avoid litigation on the merits.


140 Shaw, Uncertain Justice, (n 139)

141 Zia-Zarifi, Suing Multinational, (n 112)


143 *Torres v. S. Peru Copper Corp.* 113 F. 3d 540 (5th Cir. 1997)


The pressure has resulted in the situation that of many Alien Tort cases that have been brought against corporations; only few have survived, with many more facing a motion to dismiss because the courts thought the claims failed to adequately assert a violation of international law or because the courts believe that an adequate forum existed in the nation in which the abuses occurred. The Unocal case was the most advanced, despite a brief from the US Justice Department arguing against the plaintiffs’ use of the statute. 146

**Choice of Law Problems in MNEs’ Tort Litigation**

Even if the hurdles of jurisdiction are surmounted, the potential plaintiff who is up against a parent company in its home state is faced with the task of establishing the applicable law. The question is this; which national law should govern the activities of an enterprise doing business in many different nation-states since a formalistic response, which holds that each of the individual corporations that make up the MNE group is subject to the law of its own domicile, does not respond to the real issues. 147 Where the tortious act is deemed to have taken place in the same jurisdiction as the injury, a single *locus delicti* can be identified. For this reason, foreign plaintiffs are almost certain to find themselves subject to the laws of the state in which the injury occurred, even if that law is applied by a court of the parent state. With transnational corporate fault, however, it may be impossible to recognise a single place of the wrong because multinational group liability cases can involve many events, persons, and impacts in several countries. 148 On this subject, where a tort is committed partly at home and partly in a


147 Anderson, Transnational Corporations, (n 30)

148 Anderson, Transnational Corporations, (n 30)
foreign jurisdiction, the law to be applied will be that of the country with which the acts constituting the tort have the most real and substantial connection. In case of the fault of a multinational subsidiary, a probability that foreign law will be applied to an action tends to weigh against the English jurisdiction. In order to determine the law likely to be applied, the court will consider where each element of the tort (duty, breach of duty and damage) arose. As a result, since there is no apparent consent, it seems that the applicable law must be determined case by case by the competent forum courts.

It is of course possible that the parties may decide an applicable law in tort conflicts, on the basis of mutual agreement, but this is unlikely due to opposing interests. In most cases involving MNEs, the MNE will persistently seek to apply the law of the more favourable state, which is most likely host countries’ law. As result, the choice would appear to lie between the laws of the forum, the law governing the parent corporation, the law governing the subsidiary corporation, the law governing tortious liability. In the cases of doubt and conflicting situations, courts should prefer the forum that is most favourable to the plaintiffs.

Evaluation of the Chapter

Procedural obstacles create many problems on the way to achieving justifiable solutions against MNEs for their torts, and thus, are preventing plaintiffs finding justice in MNEs torts. The cases that have been dismissed under forum non conveniens are often the end of the matter in the sense that when a case is dismissed on that ground the plaintiffs may

149 Meeran, Process Liability, (n 68) and Chinen, Jurisdiction, (n 61)
151 Anderson, Transnational Corporations, (n 30)
152 Nygh, The Liability Of Multi-National, (n 150)
not pursue the claims no matter how legitimate their claims are. Similarly it is possible that when the defence of forum non conveniens fails the defendant may admit to the substantive claim and settle.\(^{154}\)

The ECJ’s decisions play a very important role in the reduction of jurisdiction problems in search for MNEs liability. There has been very strict application of article 2 of Brussels Regulations, which briefly regulates that companies can be sued where they are domiciled and courts cannot decide the opposite. Accordingly, the recent Owusu case of ECJ will significantly reduce application of forum non conveniens doctrine in English courts. In consideration of other alternatives to jurisdictional problems, each one still has a particular disadvantage. Thus, neither of the alternatives discussed above seem to remove application of forum non conveniens and other jurisdictional problems. Moreover, American courts still widely apply forum non conveniens.

Even overcoming jurisdictional barriers does not change the negative results of the application of traditional corporate law principles like corporate personality and limited liability in corporate groups without necessarily abolishing them.\(^{155}\) Therefore, the discussion must focus on that in case of abolishing substantive obstacles to the MNEs liability, whether the procedural problems will need special regulation or they will disappear without any action. For example, in this discussion some courts have reasoned that in providing specific statutory protections in areas such as antitrust, securities regulation, environmental, or employment laws, the legislature must have intended to override the common law forum non conveniens doctrine.\(^{156}\)

Moreover, it seems that even in the case of abolishing problems of separate personality, international civil litigation for MNEs will be problematic. The horizontal organization of MNEs makes the determination of the venue nearly impossible from the

\(^{154}\) Magaisa, Suing Multinational, (n 1)

\(^{155}\) Magaisa, Suing Multinational, (n 1)

\(^{156}\) Boyd, Inconvenience of Victims, (n 142)
perspective of where tort action is committed. Decisions and acts, which caused the tort, may be spread over many jurisdictions not necessarily making any of them clearly more convenient.

In the near future of the discussions of jurisdictional matters in MNEs groups context, it seems quite likely that, the jurisdiction discussion will be more in connection to the discussion of substantial liability in the corporate groups context. Reductions of the jurisdictional barriers in English courts in MNEs tort cases in recent years with the decisions of Lubbe and Connelly and more with the ECJ's effort, will not completely remove discussions of jurisdictions in MNEs tort. The future of jurisdictional discussions will be determined by which law regulates the substantial liability provisions over MNEs tort.

Thus, the best solution for the problem could be developed from the American courts' interpretation in ATCA litigation. The courts of any country where MNEs have subsidiaries can be entitled to hear the case with requirement of minimum contact to the forum of state where subsidiary is domiciled. Thus, the minimum contacts theory introduced by American courts should include subsidiaries since the presence of a subsidiary is an important element on the activities of MNEs. Thus, there could be broader jurisdiction over MNEs through their subsidiaries and it would reduce the claims that there is no court in the world has jurisdiction over all components of MNEs. Moreover establishing jurisdiction over MNEs through their subsidiaries might open a path to establishing MNEs group liability. The minimum contact theory is suitable for modern structure of MNEs as well. The modern horizontal structure supports the idea that the presence of any subsidiary can be considered as the presence of the group. Thus, a jurisdiction over all components of MNEs can be established by the forum where a subsidiary is domiciled and opening a way to further establishment of group liability over MNEs. This approach will abolish the application of forum non conveniens in

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157 Detailed discussion is made at chapter 2.
158 Stephens, Corporate Liability. (n 118)
MNEs tort context and will give great flexibility to plaintiffs to choose where to progress in their civil liability actions. As a result, in a horizontal structure, any jurisdiction that is resident to any components of a MNE that is involved committing the tort might be the venue for cases.
CHAPTER IV: EXISTING LIABILITY RULES FOR MNEs

Introduction

For decades a call for home countries to accept increased responsibility for regulating the unjust impacts of MNEs has been expressed through transnational and local litigation demanding fundamental action by courts. These claims aim at holding MNEs legally accountable for the negative environmental, health and safety, labour or human rights problems generated by their operations.¹ In contrast to demands for more developed tort liability, almost every legal system only provides the direct liability for groups of companies for the acts of their subsidiarires under special circumstances.² Similarly, in case law, the situations in which the courts will ignore separate corporate personality and trace responsibility back to the underlying economic reality of groups of companies and MNEs is very rare and unsatisfactory.³

On the international level, the more difficult question remains; how MNEs operations can be put under harmonised regulations; whether MNEs might be subject to one uniform regulatory structure or different regulations covering their various activities in different countries. It may be argued, in the light of previous chapters, that since a MNE has a private managerial structure capable of integrated global management over all its components, it should be subject to a single regulatory scheme. On the other hand,

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¹ Ward Halina, 'Governing Multinationals: The Role Of Foreign Direct Liability' (Briefing Paper Of The Royal Institute Of International Affairs, Energy And Environment Programme, no 18, February 2001)
³ Gallagher Lynn and Peter Ziegler 'Lifting the Corporate Veil in The Pursuit Of Justice' (1990) July J.B.L. 292
this type of uniform regulation, even if it could be achieved, would be problematic with regard to the sovereignty of independent states.  

The problem for regulations is that only a few legal systems propose a unified approach towards groups of companies and none of them regulate liability issues in tort, and therefore, national courts, with the lack of statutory provisions to trust in, use general civil and commercial legal principles to obtain justice in a particular case. More importantly, in contrast to expectations, there are new laws to extend limited liability to other business forms. For example, the UK recently enacted Limited Liability Partnership Act 2000, which has extended the imperfections of limited liability to partnerships.

However, the fact that corporate groups have not been regulated in a way that is equivalent to that of other organisational forms (e.g. joint stock companies) should not prevent us from emphasising their importance as institutions and the connected need to provide legal answers to the questions they present. Actually, it will be unfair to claim that the phenomenon of liability in the MNE context has not received any attention from regulators. Conducting a more careful examination, it will appear that legal references to corporate groups are quite frequent in most legal systems, commonly made outside the field of limited liability and tort liability issues. Thus, it is not extraordinary to find rules related to groups of companies being found in tax law, labour law, competition law and commercial law. Consequently, liability of groups of companies as a proposal appears in the context of many legislative references to corporate groups in company law and/or other abundant legislative divisions of law. Thus, it does not appear to be rational to consider corporate groups as an illegitimate institution when they are in reality considered in many different contexts. This regulatory approach has already been quite

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5 Germany, Portugal and Brazil are examples.
7 Irujo José Miguel Embid, 'Trends and Realities in the Law of Corporate Groups' (2005) 6 EBOLR 65
8 Irujo, Trends and Realities, (n 7)
a widespread reality for years but the need for comprehensive regulation including liability issues has only recently been widely discussed and understood.¹

This brings us to the purpose of this chapter, which is to provide and elaborate on the discussion of different approaches to the problems of liability of groups of companies. The discussion will have natural limitations in that only those developments, which will have relevance to group liability, will be covered here. First, courts’ approaches to the problems will be examined; basically the English case law approach will be examined together with an examination of American and other jurisdictions for comparative purposes. Afterwards, legislative examples will be given from a number of jurisdictions. It should be kept in mind that the thesis does not aim to cover every jurisdiction, nor all the regulations in the examined jurisdictions. Rather, there will be an examination of specific legislative efforts that are important for the purpose of the thesis. The case law and legislations will be tested to discover whether they have created efficient theories and principles to solve the MNEs tort liability. There will be a search to discover whether case and statutory laws have been developed enough to meet the changes and challenges that MNEs’ business, managerial, social and economical features create in law.

Case Law Approaches to Multinational Enterprises’ Tort Liability

Introduction to Case Law

It is apparent that the unfair effects of limited liability in a corporate group context have forced courts to search for alternative ways to reduce these unjust affects. While doing this, they have adopted principles that have been used in similar legal situations. Thus, case law created for liability for corporate groups could find its rationale in the

¹ Irujo, Trends and Realities. (n 7)
characteristics of different principles of law such as fraud, agency, enterprise liability or simply a requirement of justice. Alternatively liability could be imposed on a parent by reason of its failure to exercise proper control and management over its subsidiary.

The case law examination will bring us firstly the theory of veil piercing. It can simply be claimed that piercing the corporate veil is the most litigated but slightest appreciated subject in corporate law. The real function of the doctrine is to fill the gap in common law doctrines that statutory rules cannot resolve effectively. Piercing the corporate veil is not, however, the only response to possible misuse of the entity form. There are also various legal theories imposing direct liability based on tort, agency, or statutory standards introduced under certain purpose built laws. Consequently, the veil piercing doctrine here is used in a broad meaning that covers most situations under which courts interfere with separate legal personality in corporate law. The court intervention with the corporate law principles will be discussed broadly here; not only groups of corporations but also general situations where the veil piercing doctrine has been applied will be discussed, such as single person companies. However, the basic emphasis will be on the practice of courts in case of group of companies, particularly MNEs.

The application of the veil piercing principles by the courts showed different features during the past century and it differs from one jurisdiction to another. Sometimes courts forced the boundaries of established rigid principles of company law; but mostly the result of the cases in which disregarding of the corporate veil was demanded was simply a repetition of Salomon principles. The courts have never taken an evolutionary step in creating alternatives as they did when establishing the principle of separate corporate personality in Salomon. This deep commitment to the Salomon principles has prevented the courts from creating sound reasoning for interventions


11 Thompson, Piercing the Veil, (n 10)
where the corporate structure was ignored. Thus, when the courts are asked to justify the principles behind the intervention, the general response seems to be 'the situation demands' or 'justice requires'. This state of affairs creates many difficulties in such a developed legal system. First of all it creates arbitrary justice, rather than the sound application of logical legal rules to difficult factual circumstances. Thus the present complicated approach cannot satisfy those who believe that a legal system should be built, as far as possible, on a foundation of principles and certainty because the applicable principle of court interference is not clear and most importantly it has never been an alternative to limited liability company theory.¹²

In particular, the most advanced case of group liability for an MNE was established in *Amoco Cadiz*¹³ in the United States in a tort claim which is found in the decision of the US district court for the Northern District of Illinois in *re Oil Spill by the Amoco Cadiz* off the Coast of France on March 16, 1978¹⁴, where the parent company was held liable for the defaults of its subsidiary on the grounds of its close control over the operating subsidiary. In this case, the parent was also held liable as a joint tortfeasor for its own active involvement in the alleged negligence. In *Amoco Cadiz*, the court found that the vessel owning the subsidiary, its parent company and the ultimate parent of the corporate group were all individually liable. Despite some conclusions that argue that this is a case of enterprise liability, it is submitted that the decision is a piercing approach to the extent that it deals with intra-group liability.¹⁵ The court described the parent company as an integrated multinational enterprise, which is engaged through a system of subsidiaries in the exploration, production, refining, transportation and sale of petroleum products through the world. The parent itself was initially involved with and

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¹³ (1994) 2 Lloyd’s Reports 304
¹⁴ AMC 2123 (USDC-ND Illinois), Amoco Cadiz, 954 F. 2d 1279

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controlled the design, construction, operation, and management of the Amoco Cadiz. Therefore, parent and subsidiaries were liable on the grounds that: 1- this was an integrated multinational corporation. 2- the parent exercised such control over its subsidiaries that they could be considered mere instrumentalities of the parent. 3- the parent was liable on the grounds of its own active involvement in the conduct said to be negligence and through its close control over the operating subsidiaries.

Another example of advanced liability for corporate groups could be found in India. The Indian Supreme Court decision in *Mehta v Union of India AIR* 17 was binding authority for a principle of complete liability for enterprises engaged in a hazardous or naturally dangerous industry. It was therefore acceptable to lift the corporate veil between Union Carbide and its Indian subsidiary in order to hold the former liable for the tort. Thus, in *Bhopal* where the Indian authorities and the plaintiffs tried to base liability on the unity of enterprises, the idea has been repeated. 18

In the UK, as early as 1969 Lord Denning had promoted veil lifting in corporate groups’ context. Consequently, there were some important decisions such as *DHN Food Industries* 19 under which House of Lords argued that a group of companies was in reality a single economic entity and should be treated as one. However, the improved standard of liability was always rejected mostly immediately after the positive decisions. The last return to the original occurred in *Adams v. Cape Industries Plc* 20 case. It apparently indicated that there are no fundamental principles of group or single economic liability for group of companies under English Law. The facts of the case were quite complex but we can summarise that what the court had ultimately to determine was whether

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17 1987 SC 965 1086
18 Muchlinski, *Multinational*, p.329 (n 2)
19 *DHN Food Distribution Ltd. v. London Borough of Tower Hamlets* [1976] 1 WLR 852
20 *Adams v Cape Industries* [1990] 2 W.L.R. 786
judgements obtained in the United States against Cape Industries, an English registered company whose business was mining asbestos in South Africa and marketing it globally. would be recognised and enforced by the English courts. In the absence of agreement to the foreign jurisdiction, this depended on whether Cape could be considered to have been present in the United States. On a detailed examination of the facts, the answer depended on whether Cape could be presumed to be present in the United States through its wholly owned subsidiaries or through a company with which it had close business links. The court rejected all the arguments by which it was sought to make Cape liable.

The Adams v Cape Industries case is interesting for this study since it combines arguments of veil piercing accumulated during previous cases. Originally, plaintiffs structured their arguments on different principles to establish the liability on Cape Industries; these arguments were built on the past experiments during which the courts have pierced the corporate veil. These principles are vague so that they can be claimed in any situation that groups of companies are involved thus it happened so in the Adams case; the principles were;

The most used and least controversial argument for piercing the corporate veil is, at least in logic, fraud, facade or sham arguments. This exemption today is basically expressed as permitting disregard of the company veil when the corporate structure is a mere facade hiding the true facts. The theory has been exercised in the previous judgement in a variety of names.21 The fraud argument of plaintiffs in Adams was rejected stating that dividing the company and establishing new independent subsidiaries is not a sham. Secondly, the single economic unit principle suggests that groups of companies are operating as a part of the same mind and logic so they must be considered as single economic unit. However, the Adams judgement suggested that there is no general principle that all companies in a group of companies are to be regarded as one. On the contrary, the fundamental principle is unquestionably that “each company in a group of companies... is a separate legal entity possessed of separate rights and liabilities”. Thirdly, the plaintiffs argued that a company having the power to act as an

21 Muchlinski, Multinational, p.185 (n 2)
agent might do so as an agent for its parent company or indeed for all or any of its individual members if it or they authorise it to do so. However, being a subsidiary of a parent company does not necessarily mean that subsidiary companies are agents of the parent. Finally, when there is difficulty in proving the above arguments, plaintiffs argue that the interests of justice require corporate veils to be pierced. There is no apparent judgement, which has been concluded on the dependence of the interest of justice arguments. So the interest of justice has represented more than simply a way of referring to the grounds mentioned above in which the veil of incorporation has been pierced.

Consequently, the interpretation of the judgements in Adams leaves us only with three conditions in which the veil of incorporation can be lifted. First, if the court is interpreting a statute that allows the court to look beyond the corporate veil. Second, where special circumstances exist indicating that the corporate veil is a mere facade concealing the true facts, the court may lift the veil of incorporation. The third exception is the establishment of an agency relationship.

The court in Adams directly rejected the concept of a group as constituting a single economic entity and also declined to pierce the corporate veil where the subsidiary was in many aspects wholly dependent for its survival on its parent, that had been set up to shield the parent from potential liability in connection with its activities. In short, the courts have been reluctant to developing a concept of enterprise law. They seem to a greater extent to refuse to tolerate the single economic unit theory and confine the examples in which they are likely to interfere with the Salomon principle to subjective fraud by the controllers. Therefore, Adams presents a mainly harsh example of the application of the Salomon principle of strict separate corporate personality into corporate groups.

Next, the thesis will provide brief discussion of the current situation in terms of vicarious liability of MNEs. Later, there is a deeper examination of the situations where

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courts possibly pierce the corporate veil in order to evaluate compatibility of these principles to the current realities of contemporary operations and structures of MNEs. To be able to evaluate the basic principles of case law and future developments in this area, one has to look to the basics facts of each situation. Additionally, a cross-border comparative examination is helpful. Accordingly, there will be discussion of the basic principles of ignoring corporate veil, namely: veil piercing, agency and single economic unit and the interest of justice.

Vicarious Liability in Groups of Companies

Vicarious liability becomes justifiable in those cases where the liability arising from company law principles is doubtful in the light of established legal rules, but where it is necessary for parent companies to meet the losses of corporate creditors. However, the extent of a parent corporation’s liability for the acts of its subsidiaries will depend on the applicable principles of law concerning corporate group liability. Under English law plaintiffs would have some likelihood of succeeding in a claim against the parent corporation based on its breach of a principal duty owed to them. However, any claim based on vicarious liability would have virtually no chance of success because the English law of tort is reluctant to make one person responsible for the acts of another outside the master-servant, the principal-agent or the employer and independent contractor sphere of vicarious liability. Therefore, the idea of vicarious liability based on the natural structure of the group has not been accepted by the courts yet.

In order to establish vicarious liability one has to prove a strict relationship between parties. However, under the existing corporate law, (statutory and case law)

24 Muchlinski, Multinational, p. 323 (n 2)
with the limited liability principles and separate corporate personality, the possibilities of establishing vicarious liability for corporate groups are very low. That is why courts search for alternatives to impose liability on parent companies, namely veil piercing principles and its derivatives.

In reality, the courts must engage in a fact-specific inquiry into the relationship between the parent corporation and its subsidiary. To be able to impose liability on parent corporations, it must have broken some of its general duties. For example, in *Amoco Cadiz*, the parent company was held liable because all the important decisions, including those relating to the design, construction, operation and management of Amoco Cadiz, were taken by the parent company or with its authorization. However, even the parent liability in Amoco Cadiz was not direct. Liability was established because of the close control of the parent over the subsidiary.

On the other hand, the recent developments in English litigation have created some expectations. The *Cape Industries v Lubbe* and *Connolly* cases might be interpreted in a way that holds that English courts are willing to establish duties on parent companies on the basis of vicarious tort liability. However, the outcomes of cases on the legal principles are not clear since they have been settled out of court. More importantly, the main reason for granting jurisdiction against those companies was not the substantial issue of law but the non-availability of efficient judicial systems, particularly a shortage of legal aid, in the host countries where the original case should haven been brought. As a result, these cases were just concerned with jurisdiction issues and in the final outcome, the courts allowed hearing the cases in the UK; there was no decision on group liability of MNEs. For that reason, interpreting these cases as an improvement in MNEs liability is not credible and is misleading.

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28 Detailed discussion of the cases is made at chapter 3.
Even if there is a wish to establish vicarious liability, it is very difficult to determine the duties of parent companies even though some basic duties of parent corporations can be summarised under the following categories. On the lack of a clearly established principle under company law, one has to look to similar characteristics of other legal relationships, the agency-principal and the master-servant principles to determine the duties of parent corporations. The basic duty then will be acting dutifully and in good faith. There are other duties, which are mostly derivatives of the general duties. We can firstly mention choosing of skilled directors; if this choice is negligently made, the carelessness will be identifiably linked with any damage that subsequently results from the negligence of the directors. Thus, the corporation might be held liable for not performing its primary duties. The second duty is duty to warn; the work may be hazardous to third parties unless specific information held by the employer is revealed to the subsidiary. Finally, there is a duty to supervise within the specific sphere of the contracts of employment, but there is no general duty to supervise the activities of a subsidiary as an independent company.

The discussion of determining the basic duties of MNEs has been going for decades. There are several attempts at different levels to determine these duties. One of the recent and most important attempts has been under the UN Economic and Social Council. UN norms determine basic duties for multinational enterprises under different titles. Accordingly, they have duties for human rights, labour, consumer, and environmental issues. However, similar to other code of conducts and international instrument on this matter, these norms do not have strong enforcement mechanisms since they are non-binding instruments and are unlikely to become the subject of a

30 Baughen, Corporate Accountability, (n 26)
31 Baughen, Corporate Accountability, (n 26)
32 Baughen, Corporate Accountability, (n 26)
binding treaty in the near future.\textsuperscript{34} Therefore, it is not possible to claim that parent companies have the same duties under vicarious liability rules since there is no court mechanism or national law to enforce these duties on MNEs. Thus, it is difficult to claim that these norms are part of the legal systems and should be considered as binding legal rules. Similar to UN Norms, other international instruments cannot be considered as binding in determination of the duties of MNEs. However, these initiatives must be considered as examples in the determination of the basic duties of parent companies and groups of companies in cases where vicarious liability is applied. Alternatively, it can be assumed that these norms are the basic responsibility of MNEs and therefore, legal systems should introduce vicarious liability of MNEs in breaches of these norms.

These facts lead us to the question of whether vicarious liability serves as an effective means of enforcing group liability standards in a cross-border context of MNE activities. One is forced to admit that it plays no role, at least for the moment. The closest example of established liability, the case of \textit{Amoco Cadiz} does not meet the criteria of vicarious liability. Even courts establish legal rulings based on the ideas mentioned in the previous paragraphs. These rules create very partial and rare liability since there has to be a connection between parent companies fraudulent acts and the damage, which makes establishment of liability very difficult.\textsuperscript{35} A parent company might always avoid liability by proving it has performed its duties at a required level. In cases where the parent has failed in its duties, the connection must be proven between its act and the damage. Even if all the conditions have been established, it is very difficult to establish that this is a group liability because rather than ignoring separate legal personality, this situation might be defined as another person being found liable for its participation in a tortious act.

This brings us to the discussion of modern structures of MNEs. The vicarious liability discussed above could be applied to parent companies for their miscontrol or in not taking necessary control to prevent a tort. Accordingly, there has to be a strict relationship between the parent and the subsidiary. However, the control relationship in a modern structure has been differentiated and there is a more horizontal (cultural control) rather than strict control and day-to-day involvement of the parent suggested by vertical structure. Any claim of vicarious liability against a parent in a horizontal structure therefore has little chance of success since it aims to make one person liable for tort of the other in certain conditions. Thus, the theory of vicarious liability based on entity liability has a better chance of success in application to smaller and vertically structured groups of companies rather than to bigger and more advanced structured MNEs.

Piercing the Corporate Veil

The corporate veil is based on the distinction between the personalities of the every each company within groups of companies. It follows that a person who decides on the actions of another may take advantage himself of a series of juridical devices in order not to be responsible for the consequences. 36 Accordingly, the basic principle behind the veil piercing is that where a company is used for an illegal or improper purpose or where there is a ‘necessity to achieve justice’, the corporate veil must be pierced. 37 Hence, in relation to the liability of groups of companies, the common law doctrine of piercing the corporate veil might offer a means of justifying liability in circumstances where the

35 Anderson, Transnational Corporations, (n 4)
subsidiary has insufficient assets to meet the claims against it, but where, the case for compensation of the claimants is hard to oppose on justifiable grounds.  

The general rule, under both English and US law, is that if the parent had a certain level of control over the subsidiary, the court may lift the corporate veil and hold the parent liable if additional conditions are met. Therefore, the parent corporation may be held liable for the torts of its subsidiary where the nature of their corporate relationship suggests that the subsidiary has become a mere instrumentality or alter ego of the parent corporation. However, these piercing the veil situations, outside the areas justified by statutory interpretation, have occurred only in very specific circumstances throughout the twentieth century. For example, in the United States the courts have never lifted the veil so as to remove limited liability in the case of a public company and will not do so as a matter of routine in private companies.

In Anglo-American jurisprudence, the piercing the veil doctrine can be applied to both contract and tort liability. The simple logical thinking asserts that courts should pierce the corporate veil more often in tort cases than in contract cases because tort victims do not choose their association with a corporate entity, while plaintiffs with contractual relationships have the opportunity to evaluate the risks of doing business with the corporation and voluntarily disregard these risks. However, Professor Thompson's empirical study of corporate veil piercing cases in the US pointed out that courts pierced more often in the contract context than in the tort context and that this

38 Muchlinski, Multinational, p. 325 (n 2)
39 Lutter M, 'Enterprise Law Corp. vs. Entity Law Inc. Philip Blumberg's Book from the Point of View of an European Lawyer' (1990) 38 American Journal of Comparative Law 949
40 Berkamp L and Pak Wan-Q, 'Piercing the Corporate Veil: Shareholder Liability for Corporate Torts' (2001) 8 Maastricht J. Of European and Comparative Law 167. A recent survey of the veil piercing in Belgium, England, Germany, and the Netherlands found that the doctrine is applied only in clear-cut cases of "abuse of limited liability".
41 Davies Paul L, Gower and Davies' Principles of Modern Company Law (Sweet & Maxwell, London 2003) p.190
difference is statistically significant. Moreover, there is lower percentage of piercing within corporate groups than to individual shareholders. There is no trend over time that courts appear to be moving toward permitting piercing in more and more situations. The Thomson studies for American veil piercing jurisprudence demonstrate general confusion of this area of law in the finding that factors listed were less objective and contained a total of eighty-five factual reasons for piercing the veil collected from previous research in the area and a sampling of the cases in the data set for deciding whether to pierce. Further, it was necessary to group the factors into twelve different areas to attempt to document the standards of the court.

An empirical study in England indicates that the courts in particular have been likelier to lift the veil between a closely-controlled company and its subsidiary. They have been likelier both to lift the veil and to keep the veil in place when asked to do so by a governmental body than when asked to do so by a company or its shareholders. More importantly they have shown themselves consistently unwilling to lift the veil to enable the victims of a company’s tort to recover from its shareholders.

Moreover, in another study that examines the 55 Australian cases involving insolvency and demanding piercing the veil, the researcher came to a conclusion that the percentage of piercing the veil is 24% and in recent years there is an increasing demand for piercing the veil and most of the demands are dependent on contract or statutory basis. Piercing the veil demand for tort actions were just 5 and in 2 of them the court

43 Thompson, Piercing the Veil, (n 10)
44 Thompson, Piercing the Veil, (n 10)
45 Thompson, Piercing the Veil, (n 10)
46 Thompson Robert B, ‘Piercing the Corporate Veil: An Empirical Study’ (1990-1991) 76 Cornell L. Rev. 1036 These areas are; undercapitalisation; failing to follow corporate formalities; overlap of corporate records; functions of personnel; misrepresentation; shareholder domination; intertwining and lack of substantive separation; use of the conclusory terms “alter ego” and “instrumentality”; general ground of fairness; assumption of risk; refusal to let a corporation pierce itself; and statutory policy.
decided to pierce the corporate veil. The study also reveals the basis for justifying piercing the veil; plaintiffs have argued mostly on the basis of agency, 34 cases and later they argued on the basis of group enterprises, fraud and unfairness. The study indicates that the percentage of piercing the veil on the group enterprise basis is the lowest. As a result, the Australian approach almost mirrors the American and English approaches. Australian courts have pierced the veil in the same reasons, as do American and English courts; agency, fraud, sham or façade, group enterprises, unfairness and injustice. The courts pierce the corporate veil less frequently when the controller is a parent company than when the controller is a one or more individual shareholders. And the group enterprises argument is the least likely basis to pierce the veil. Courts pierce more frequently in a contract context than in a tort context.

There is another confusing characteristic of the veil piercing doctrine that the practical application of veil piercing doctrine might reveal situations under which court based their explanation for piercing the veil. The most common reasons for piercing the corporate veil are: first is the discovery that the corporation is merely an alter ago of the shareholders; a subsidiary corporation is owned and controlled by the parent and the subsidiary has been relegated to the status of an alter ago of the parent and the recognition of them as separate entities would lead to an inadequate or fraudulent result. The second one is fraud and misrepresentation; when a corporation misrepresents the nature of its activities, its ability to perform, its financial condition, or its financial structure. The third one is under-capitalization. The list grows by moving towards a

49 Ramsay, Models Of Corporate, (n48)
51 Ramsay and Noakes, Piercing The Corporate Veil, (n 50)
52 Ramsay and Noakes, Piercing The Corporate Veil, (n 50)
detailed examination but it is unnecessary to discuss every mentioned veil lifting reason since it depends on the interpretation of cases by the courts at the time.\textsuperscript{54}

Moreover, the degree of piercing and reasons for piercing are very different in many cases. Establishing group based liability is not the only reason in veil piercing in corporate group concept; rather the veil piercing doctrine pursues many other legal objectives.\textsuperscript{55} Thus, the application of lifting the veil is not always disadvantageous to corporate groups. In some situations veil piercing doctrine is applied in favour of corporate groups. In this sense, Ottolenghi divides the reasons behind the veil piercing at least into four categories. The first one is \textit{peeping behind the veil}; the veil is lifted only to get information involving the person who controlled the company.\textsuperscript{56} The second one is \textit{penetrating the veil}; the aim is to impose upon the shareholders responsibility for the company’s act or to establish their direct interest in the company’s assets.\textsuperscript{57} The third one is \textit{extending the veil}; the veil of each one of the components is lifted only to draw it again over a large number of components.\textsuperscript{58} The last one is \textit{ignoring the veil}; this is the most extreme one and applied just if the court thinks the company is established not in the commercial ground.\textsuperscript{59} The examples are provided in order to illustrate the point that the application of the doctrine, with its complexity, can produce results that contradict the equitable policy considerations that lies behind the doctrine.\textsuperscript{60}

Based on these practical facts mentioned earlier, the courts concentrate on three main doctrines to explain the reasons for piercing. It will be useful to examine the

\begin{itemize}
\item \textsuperscript{54} Dobson JM, ‘Lifting the Veil in Four Countries: The Law of Argentina, England, France and the US’ (1986) 35 ICLQ 839
\item \textsuperscript{55} Ottolenghi S, ‘From Peeping Behind The Corporate Veil To Ignoring It Completely’ (1990) 53 MLR 338
\item \textsuperscript{56} \textit{Daimler v Continental Tyre Co} (1916) 2 AC 217 is an example.
\item \textsuperscript{57} Section 24 of Companies Act 1985 is an example.
\item \textsuperscript{58} Piercing the veil on the basis of single enterprise argument falls under this section. The issue will be discussed in a detailed way below. (p 194)
\item \textsuperscript{59} Fraudulent trading clauses in Insolvency Act fall in this category. The issue will be discussed in a detailed way below. (p 203)
\item \textsuperscript{60} Thompson, Piercing...Empirical Study, (n 46)
\end{itemize}
principles behind the veil piercing in order to test their efficiency in terms of MNEs tort liability.

**Fraud Doctrine**

Fraud consideration for veil piercing can lead disregarding the legal entity doctrine in the Anglo-Saxon law and the concept of fraud is contained in most of the English decisions. Fraud in English and American law can be found a remedy at common law and remedies in equity. The fraud approach to veil piercing is a sanction to which the courts turn when they think that the company was not founded for commercial or other sound grounds, but only as a means to defraud or defeat creditors or to circumvent laws.

In fraud cases the court will look directly at the realities of the situation and reference must be made to further matters, which the courts consider. Some examples of references are; the type of company- a closely held company, subsidiary or holding company; the motives for the formation of the company – commercial ones as opposed to fraudulent purposes, defeating creditors, evading laws etc. the type of legal action – a claim in tort, contract, bankruptcy etc. The identity of the person seeking the lifting of the veil – a distressed third party or the controlling shareholder himself is also important.

In *Gilford Motor Company Ltd v Horne*, Mr. Horne was an ex-employee of the Gilford motor company and his employment contract provided that he could not solicit the customers of the company. In order to defeat this, he incorporated a limited company in his wife's name and solicited the customers of the company. The company brought an

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61 Dobson, Lifting the Veil, (n 54)
62 Ottolenghi, From Peeping, (n 55)
63 Ottolenghi, From Peeping, (n 55)
64 [1933] Ch.935
action against him. The Court of Appeal was clear that the company was formed as a device, in order to mask the effective carrying on business of Mr. Horne. In view of this sham, the Court of Appeal declined to recognise the separate legal personality of the limited company. Jones v Lipman has strengthened the decision in Gilford. Trustor AB v Smallbone, a recent case, has also repeated the power of courts to pierce the veil in case of fraud.

In Re a company, Cumming-Bruce LJ stated that the court would use its powers to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficiency of the corporate structure. In another decision, Creasy v. Breachwood Motors limited where the company had been used for an illegal or improper purpose, the court pierced the corporate veil where the business of a defendant company in litigation was transferred to an associated company so as to leave the defendant company without asset.

In fraud cases, not only dishonesty is examined but also fraudulent purpose is required in order to pierce the veil and establish liability. This means that it is not sufficient just to prove that the company was established dishonestly but also it must be proven that the transaction, which caused to the damage, has been conducted for fraudulent purposes. Accordingly, under the fraud doctrine, three elements must generally be shown by a plaintiff before the two entities will be treated as one for legal

65 Payne J, 'Lifting the Corporate Veil: A reassessment of the Fraud Exception’ (1997) 56 CLJ 284
66 Payne, Lifting the Corporate Veil, (n 65)
67 [1962] 1 WLR 832 Jones v. Lipman. Under the case a man contracted to sell his land and thereafter changed his mind in order to avoid an order of specific performance he transferred his property to a company. Russell judge specifically referred to the judgments in Gilford v. Horne and held that the company here was 'a mask which (Mr. Lipman) holds before his face in an attempt to avoid recognition by the eye of equity' he awarded specific performance both against Mr. Lipman and the company.
68 [2001] 3 All ER 987
69 Re a Company Ltd [1985] BCLC 333
71 Creasy v. Breachwood Motors limited [1992] 2 BCC 638
purposes. The parent company must control over the subsidiary, not just through stock ownership but through a complete domination of the policy. 2- The control must be used to commit a fraud or wrong by the parent through the subsidiary, to avoid legal obligations or statutory duties or to unjustly limit the plaintiff's rights. 3- The above-mentioned control and breach of duty must cause the injury or loss complained of.

The first requirement is that the subsidiary’s lack of separate independent identity of its own. Such lack of separate identity may arise in two ways: excessive control by the parent and the lack of real separate existence. In the classic doctrinal formulation, control must extend to the extreme where the subsidiary has no mind, willpower, or existence of its own. In other words, there must be excessive domination. In order to answer the domination question it should be first mentioned that the issue is not simply the power to control but it is the exercise of control; total control or equally the absence of any independent judgment. Shortly the subsidiary should exist only in name. In the case of Lowendahl v. Baltimore & ORR the required level of control has been described: “Control, not merely majority or complete stock control, but complete domination, not only of finances, but of policy and business practices in respect to the transactions attacked so that the corporate entity had at the time no separate mind, will or existence of its own”. How these factors are balanced in practice, and when alter ego liability will be found once control is established, is subject to a fact-specific inquiry in each case.

72 Lowendahl v. Baltimore & ORR 247 App. Div. 144, 154 (1st Dept. 1936). These requirements are established in this American case but also accepted in some form in the UK.
73 Payne, Lifting the Corporate Veil, (n 65) and Cashel, Groups of Companies, (n 15) p. 28
75 Blumberg, Accountability of Multinational, (n 74)
76 Whincup Michael, 'Inequitable Incorporation- the Abuse of a Privilege' (1981) 2 Company Lawyer 158
78 Farmer, Parent Corporation, (n 42)
Second prerequisite to apply the piercing the veil under fraud doctrine is that the control must be used to commit a fraud or wrong by the parent through the subsidiary. It must be showed that the subsidiary has been used as a shield to complete some fraudulent or unjust or inequitable conduct for the benefit of the parent or controlling shareholder. The conduct must be morally chargeable or primarily unfair.\textsuperscript{79}

A final requisite is that the defendant's conduct has to have caused injury to the plaintiff. It is obvious that if there is no harm to the creditors, there is no need to pierce the corporate veil.

It is very difficult to congregate these three conditions in a single case. Therefore, the fraud based piercing the veil cases discloses no very obvious pattern, and it remains hard to predict when the courts will lift the veil in practice.\textsuperscript{80} Moreover, under \textit{Adams v Cape Industries}, it was decided that there was no fraud for a group of companies for choosing to use the doctrine of separate corporate personality in such a way as to minimise its group exposure to future liabilities. The logic behind this is that under the English perspective, parent corporations are no more than a shareholder.\textsuperscript{81} A company exists for the benefit of shareholders so they can manage their affairs as they wish, provided they acted in good faith and the desire to limit liability is not a fraud.\textsuperscript{82}

In America in the case \textit{Pepper v Litton} \textsuperscript{83} the judgement explicitly recognises that the law's primary duty is to protect the citizen against sharp practice and, particularly, which is brought about by abuse of the legal principles in question.\textsuperscript{84} Accordingly, fraud doctrine has been applied in broader approach in the USA. Professor Blumberg sets out

\begin{footnotesize}
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\item \textsuperscript{79} Blumberg, Accountability of Multinational, (n 74)
\item \textsuperscript{80} Mitchell, Lifting the Corporate Veil, (n 47)
\item \textsuperscript{81} \textit{Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd} [1983] Ch 258, [1983] 2 All ER 563, [1983] BCLC 461, CA
\item \textsuperscript{82} \textit{Adams v Cape Industries} [1990] 2 W.L.R. 786
\item \textsuperscript{83} 308 US 295,310,313, (1939)
\item \textsuperscript{84} Whincup, Inequitable Incorporation, (n 76)
\end{itemize}
\end{footnotesize}
three requirements for the piercing the corporate veil.\textsuperscript{85} The first one is a demonstration that the subsidiary lacks separate independent identity of its own. Such lack of separate identity may arise in two ways; excessive control by the parent and lack of the forms of separate existence. Control is the most ambiguous element of the rule because at least eleven individual factors may be considered by a court in determining the degree of control exercised by the parent. The lack of independent action by the subsidiary’s officers and directors, if directly proven, is conclusive.\textsuperscript{86} The second traditional requirement for piercing is a showing that the subsidiary has been used as a shelter to accomplish some fraudulent or unjust or inequitable behaviour for the benefit of the parent or controlling shareholder. The conduct must be ethically guilty or basically unfair. The final requisite, one frequently ignored in practice by the courts, is that the defendant’s conduct has to have caused an injury to the plaintiff. As a result, the conditions in America are not fundamentally different than those in England.

Common-Law Agency Doctrine

Agency is a legal relationship between a principal and natural and legal persons with permanent authority to prospect for and visit customers with a view to negotiating and when appropriate concluding agreement in the name and for account of the principals.\textsuperscript{87} Agency law is a varied and extended institution, based both on the law of torts and contract law. It centres on the notions of control and authority which are exerted by one person over another. Liability being imposed on the controller -principal- for the acts performed by the person subject to control -agent- within his authority.\textsuperscript{88} Accordingly, the separate corporate personalities of two different companies will also be

\textsuperscript{85} Blumberg, Accountability of Multinational. (n 74)
\textsuperscript{86} Graham Boyce L. ‘Navigating the Mists of Metaphor: An Examination of the Doctrine of Piercing the Corporate Veil’ (1990·1991) 56 J. Air L. & Com. 1135
\textsuperscript{88} Dobson, Lifting the Veil, (n 54)
ignored if one of them is held to have been acting as the agent for the other.\textsuperscript{89} For an agency relationship, the common law requires not merely control but also a consensual transaction. The parties must agree on that the subsidiary is acting for the parent - the principal with subsidiaries typically utilised to protect the parent corporation from liability.\textsuperscript{90} In some cases, courts accept implied agency relationship and impose the same liabilities on parties for this relationship. However, it requires establishment of many factual relationships between the parent and the subsidiary, which is very difficult to indicate under the current structure of MNEs and groups of companies.\textsuperscript{91} Therefore, it should not be surprising that very few parent-subsidiary relationships satisfy the common law requirements for an agency relationship.\textsuperscript{92}

The agency rules are illustrated in a number of English decisions.\textsuperscript{93} In \textit{Smith, Stone and Knight Ltd. v. Birmingham Corporation}\textsuperscript{94}, a Birmingham Corporation, a local government authority, compulsorily acquired premises occupied by The Birmingham Waste Co. Ltd., a wholly owned subsidiary of Smith, Stone and Knight. In order to succeed in an action for compensation for loss of business, the parent company had to establish that the subsidiary was its agent in conducting business on the premises.\textsuperscript{95} Atkinson J found that in conducting business on the premises the subsidiary had acted as the parent’s agent. In \textit{Smith, Stone}, the subsidiary was described as the agent or employee or tool or simulacrum of the parent company because it was carrying on business on behalf of the parent. Therefore, this particular feature of agency in English and US law has created an idea that is especially well adapted to cases of abuse of corporate personality.\textsuperscript{96}

\textsuperscript{89} Gallagher and Ziegler, Lifting The Corporate Veil (n 3)
\textsuperscript{90} Blumberg, Accountability of Multinational, (n 74) and Dobson, Lifting the Veil, (n 54)
\textsuperscript{91} Detailed discussion is made at chapter 2.
\textsuperscript{92} Blumberg, Accountability of Multinational, (n 74)
\textsuperscript{93} \textit{Ebbw Vale UDC v South Wales Traffic Licensing Authority} [1951] 2 KB 266
\textsuperscript{94} [1939] 4 All ER 116
\textsuperscript{95} Gallagher and Ziegler, Lifting The Corporate Veil, (n 3)
\textsuperscript{96} Avgitidis Dimitris K, \textit{Group of Companies; The Liability of Parent Company for the Depths of Its Subsidiary} (Sakkoulas, Athens-Komotini 1996) p. 164
However, the current thinking on agency as a means of veil-piercing is inadequate for the following 4 reasons. The first, there is a disagreement over whether or not agency, as currently applied, actually represents veil-piercing. The second, there is a logical inconsistency of asserting that the corporation is puppet, under the complete control of another, while simultaneously it is an independent legal actor who can enter into binding agency agreements. The third, the majority of cases traditionally dealt with under agency are most likely mere instances of statutory interpretation. The fourth, it is very difficult to prove an agency relationship under the complex structure of groups of companies since veil piercing based on agency argument requires clear indication of connection between the parent and the subsidiary. However, the examination of structure of modern MNEs suggests the opposite.

In majority of the cases, the subsidiary was described, either expressly or impliedly, as the agent of its parent. However, the description of the subsidiary as an agent of the parent was not based on the typical elements of an agency relationship but on a number of facts suggesting that the subsidiary was closely controlled by its parent. The term agent was merely used as a description, interchangeably with other labels, such as tool, simulacrum, facade, alter ago and creature, in order to emphasise the substantial degree of the parent's domination over the affairs of the subsidiary.

In the case where the court attempted to examine whether the relationship between the parent and the subsidiary was that of a principal and an agent in the strict legal sense, it was pointed out that it is necessary to bear in mind the fundamental principle that the relationship of principal and agent can only be established by the consent (actual or implied) of the principal and the agent. And in the absence of such consent, the supposition of an agency relationship was rejected by English courts. Therefore, it is not surprising that in *Adams v Cape Industries* on the agency issue for the acts of the

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97 Neyers, Canadian Corporate Law, (n 12)
98 Avgitidis, *Group of Companies*, p. 170 (n 96)
99 *Atlas Maritime Co SA v Avalon Maritime Ltd* [1991] 1 WLR 917
100 Avgitidis, *Group of Companies*, p. 170 (n 96)
subsidiary on the part of the parent corporation, the court did not give any credits to the agency claims. The explanation was simple as that there is no real or expressed agency agreement.

Examining the characteristics of the agency relationship, one sees no inaccuracy in coming to the conclusion that the agency argument is a variation of fraud doctrine. It is just better suited to the complexity of corporate groups since two separate personalities are involved in the case. Where the fraud doctrine was not enough to establish liability, the agency was created on the same basic necessity of that the parent has excessive control over the subsidiary. Thus, similar to the fraud doctrine, agency theory sees the liability as liability of controller for its unlawful control over its subsidiary. Thus, it can be claimed that agency argument is not functional enough to be applied to tort committed by subsidiaries of MNEs that operate under complex structure.

**Single Economic Unit Doctrine**

In *DHN Food Distribution Ltd. v. London Borough of Tower Hamlets* Lord Denning M.R. decided on the treatment of a holding company-subsidiary relationship as a single economic unit commenting that there is evidence of a general tendency to ignore the separate legal entities of various companies within a group and to look instead at the economic entity of the entire group. And it was decided when a parent company owns all the shares of the subsidiaries “*These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says.... the three companies should, for present purposes, to treated as one*”. *DHN* is probably the strongest case, in England, in the tort victims’ favour because it was strongly arguable that the court there did not base itself on the particular statutory provisions but on a more

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101 Baughen, *Corporate Accountability*; (n 26)
102 [1976] 1 WLR 852
103 Gallagher and Ziegler, *Lifting The Corporate Veil*, (n 3)
general approach founded on the idea of single economic entity. Thus, the development somehow was very fundamental for corporate law. After the decision of the Court of Appeal in *DHN*, it has been said that the courts may disregard Salomon’s case for corporate groups wherever it is just and equitable to do so. However, the rejection of these claims came immediately by the House of Lords in *Woolfson v. Strathclyde Regional Council*. The court indicated some doubt whether the court of Appeal in the *DHN* case had properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere facade concealing the true facts. Moreover, the subsequent views expressed by the Court of Appeal in *Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd. and Ors* indicate that the *DHN* decision was an abnormality. It is suggested that the decision in *Multinational Gas* can be considered in the same light as that of *Salomon*, in that no injustice would have been caused to any party by upholding the separate entity principle.

Consequently, the sense of the judgments in *Woolfson, Multinational Gas* and *Industrial Equity Ltd v. Blackburn* indicate unmistakably that the decision of the Court of Appeal in *DHN* was abnormal and that the principle that each company in a group of companies is a separate legal entity possessed of separate legal rights and liabilities is now unchallengeable by judicial decision. More recently, in *Polly Peck International Plc* (in administration) Robert Walker J emphasised that “it was not open to the court to disregard the principle of separate corporate personality and treat a

104 Ottolenghi, From Peeping, (n 55)
105 Davies, Gower and Davies p.185 (n 41)
107 [1978] SLT 159
108 Avgitidis, Group of Companies, p. 174 (n 96)
109 [1983] 2 All E.R 563
110 Gallagher and Ziegler, Lifting The Corporate Veil (n 3)
111 [1977] 137 CLR 567
113 [1996] 2 All E.R (Ch D)
closely integrated group of companies as a single economic unit on the basis merely of perceived injustice, particularly in cases where the separate legal existence of these companies assumed greater importance once they became insolvent”.

In the application of the single economic unit theory, parent and subsidiary were treated as a single economic unit when there was evidence indicating that the parent could make any arrangements which they pleased in regard to the management of the business of the subsidiary, or that every step taken by the subsidiary was determined by the policy of the parent, or that, the subsidiaries were bound hand and foot to the parent company and must do just what parent says or that the parent controlled the purse strings, on an item-by-item basis.114 Similarly, courts in the United States and in the EU use some form of the economic unity theory to pierce the corporate veil.115 As similar to English doctrine, under the theory, the main factor in piercing the corporate veil is the level of control by the parent over the subsidiary. 116

In simple theory, the agency and the single economic unit approaches provide more reliable principles in establishing liability on parent corporations because two separate personalities are confirmed but the use of fraud principles tend to lead to the conclusion that there is only one person involved.117 That is why it is a fact that in some American cases fraud and agency principles have been brought together to govern the particular situation of abuse of control.118 However, it may be concluded that there is no substantial difference between the English interpretation of the agency and the single economic unit and the fraud doctrine. In reality the agency principles applied in Smith may be used as a test for inferring that the subsidiary is the instrument of the parent. Both the English inferences and the American doctrine have the influence of treating parent and subsidiary companies otherwise than the independent legal entities and they deeply trust in facts which may differ from a case to case but they all resemble each

114 Avgitidis, Group of Companies, p. 182 (n 96)
115 Bakst, Piercing the Corporate Veil, (n 53)
116 Bakst, Piercing the Corporate Veil, (n 53)
117 Dobson, Lifting the Veil, (n 54)
other in idea that a **substantial degree of managerial control** is exercised by the parent company. The only difference is that the American courts have imposed liability on the parent company on the ground of such **control** more often than the English courts have generally done.\(^{119}\)

Consequently, the development of agency and single economic unit theories find its logic on **excessive control** of subsidiary and using the subsidiary as sham. Therefore, the applications of agency and single enterprise principles have easily been shielded by the *Salomon* principles.\(^{120}\) Liability principles that rest on agency and single economic unit become no more than imprecise, symbolic variations of the piercing the veil jurisprudence on the principle of fraud.\(^{121}\)

**Abandoning the Veil Piercing**

The first striking conclusion from the court-generated liability for group of companies is that generally the corporate veil will not be pierced unless the corporate shareholder dominates the corporate subsidiary and the corporate shareholder has engaged in a fraudulent or illegal conduct or other improper conduct, which has generated an injustice. Thus, the doctrine of lifting the veil plays a small role in liability discussions in English law, except for the area of particular contracts or statutes. Even where the cases for applying the doctrine may appear very logical, i.e. under-capitalised, one-person company, which might or might not be element of a corporate group, the courts are unlikely to pierce the corporate veil.\(^{122}\) In their legitimacy effort, the courts always refer to lack of legislative effort on the issue claiming that even though the legislature has

\(^{118}\) Dobson. Lifting the Veil. (n 54)

\(^{119}\) Avgitidis. *Group of Companies*, p. 189 (n 96)

\(^{120}\) Baughen. *Corporate Accountability*. (n 26)

\(^{121}\) Blumberg PI. *The Multinational Challenge to Corporation Law* (Oxford, 1993) p. 143
intervened to deal with various issues relating to corporate groups, they have not acted on this particular matter. As a result English courts consider that their function in formulating any overreaching principle of enterprise liability is greatly circumscribed. The courts, even the House of Lords, are reluctant to intervene in a matter that requires strong legislative attention.\textsuperscript{123}

Therefore, it is logical to claim that the devotion to limited liability in corporate groups is a common characteristic of modern laws as one American court decided, "The doctrine of limited liability is intended precisely to protect a parent corporation whose subsidiary goes broke. That is the whole purpose of the doctrine, and those who have the right to decide such questions, that is, legislatures, believe that the doctrine, on the whole, is socially reasonable and useful. We think that the doctrine would largely be destroyed if a parent corporation could be held liable simply on the basis of errors in business judgment."\textsuperscript{124}

However, blaming only parliaments for the MNE liability problems is not very convincing since the same judicial system created the current inflexible regime of liability under the principles of limited liability and veil piercing. It also is interesting that there has been little criticism of the \textit{Salomon} principles and little demand for its modification either judicially or legislatively. Thus, Professor Prentice went further to claim that, on current form, the \textit{Salomon} principles may endure for another hundred years.\textsuperscript{125}

Therefore, under these current rigid principles, the court created system of liability in common law is very ill developed. There is no clear set of principles for any emerging doctrines for liability and it is difficult to predict when and under which conditions courts will disregard the separate entity principle. The need for English courts to resort

\begin{thebibliography}{124}
\bibitem{122} Davies, \textit{Gower and Davies}, p. 189 (n 41)
\bibitem{124} \textit{Radaszewski V. Telecom Corp.} 1981 F.2d 305
\bibitem{125} Prentice, \textit{Veil Piercing and Successor}, (n 123)
\end{thebibliography}
to such symbolic terms as mere fraud, sham, dummy or alter ego in their judgments indicates their difficulties. In America as well, Blumberg noted that one of the most serious limitations of US law in dealing with group liability has been the arbitrary piercing the veil jurisprudence since the metaphoric use of piercing law has prevented US courts from developing a clear general concept of group responsibility. Piercing the veil for a parent corporation with a subsidiary facing tort claims is uncertain, which makes a settlement difficult and litigation costs high.

In consideration of the piercing the veil theory from a broader perspective, such an inadequately developed and complex structure of case law, even incapable of creating solutions for private, one-man limited company, cannot be applied in modern times corporate groups, particularly to MNEs with complex horizontal structure. All the basics of the veil piercing doctrine have been built on excessive control by parent corporation over subsidiaries. However, under the modern complicated horizontally structured corporate groups, the control has been spread over subsidiaries, which appears in two ways: there is more self-dependent and self-operated subsidiaries and there is changing components control and influence over others operation in the group. Consequently, in this new and complicated structure, it is almost impossible to establish a simplified method of control under which excessive control of one entity over another is established. Thus, it is difficult to apply piercing the veil principles in subsidiaries’ torts since there is no easy proof of control of one particular entity over another.

One can claim the single economic unity principle was in a way a try to adopt the new structure to the case law. I would rather consider the single economic unit as a first reaction to the liability problems in corporate groups, particularly in vertically integrated groups. The problems of court created liability source from the fact that efforts to create liability theories were inefficient and apparently fruitless and at the time of the decisions, they were completely outdated because the complexity of MNE structure was

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127 Thompson, Piercing...Empirical Study, (n 46)
already at the next level that the case law could not predict. That is why the bigger and more complicated corporate groups get the less likely they are to be subjected to piercing to the veil principles. Referring back to examination of corporate structure and complicated ownership and managerial structure of the given examples in the second chapter of the thesis, there are multi-veil corporate groups. In those groups there are much more complex ownership structures than that the veil piercing theory suggests. Moreover, these complex ownership structures require much more complex horizontal managerial control and operation.

In conclusion, the main problem of veil piercing theory is its dependency on the control theory which makes its application very weak and rare. In cases of horizontally structured MNEs group, the control theory is inapplicable. However, the piercing the corporate veil theory still depends on control theory under which excessive control of parent over its subsidiaries is a requirement. Thus, the control theory is much more suited to vertically organised corporate groups under which the divisions between subsidiaries and parent is more apparent and the parent exercise some certain level of control over its subsidiaries. Consequently, piercing the veil theory is now obsolete and must be abandoned in favour of liability theories, which are based on modern structures of MNEs.

Moreover, in the international area, in the great majority of cases, current international treaties hardly provide victims with any specific tools to pierce the veil. The existence of a customary international rule obliging a state to control and prevent the dangers resulting from the activities of their MNEs abroad is highly doubtful and not yet confirmed by any international practice. As a result, group liability might occur for subsidiary's torts in some jurisdictions, but be shielded from liability in others. These

128 Detailed discussion is made at Chapter 2.
129 Detailed discussion is made at Chapter 2.
130 Scovazzi, Industrial Accidents, (n 36)
factors lead to the conclusion that victims, companies and other parties of the conflict might not be able to predict its exposure to liability within a jurisdiction.\textsuperscript{131}

Statutory Laws related to Liability for Group of Companies and MNEs

There is an argument that lawmakers in the UK have no intention to change the principles of \textit{Salomon}, because with the numerous passing of different Companies Acts there has been plenty of time for parliaments to produce such a change had it had a mind to do so.\textsuperscript{132} Despite this apparent lack of interest in regulating MNEs liability, there are signs that at least some regulators are waking up to act and impose liability on MNEs thanks to strong public arguments. However, the regulations still mostly aim at issues where public pressure is irresistible or in very specific cases for specific problems.

Therefore the statutory lifting of corporate veil is given very little attention in scholarly literature. Even though there are some regulations, which directly or indirectly require a lifting of the corporate veil, it is obvious that these regulations cannot create a situation under which corporate groups liability is achieved because the protection provided by such measures is invoked very rarely. For the purpose of this study, the importance of these regulations lies in the fact that, as the laws indicate, in case of need alternatives to the limited liability doctrine could be created. Moreover, examination of statutes and principles will provide an answer to the question of whether regulators have adapted to the modern characteristics of MNEs or the regulations are still based on the misconception of vertical structure because one of the reasons of failure of the statutory law is that they cannot fully embrace the current realities of groups of companies.

\textsuperscript{131} Farmer, Parent Corporation. (n 42) \\
\textsuperscript{132} Bowmer, Company law, To Pierce. (n 37)
This thesis examines the current situation and discussions in the United Kingdom and developments in European Union as central to the research. Moreover, there will be an examination of some interesting legislations from different jurisdictions. The German Stock Corporation Act has attracted lots of interest from scholars for being unique regulation of corporate groups. For this it deserves an examination. The American legislation of Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) is very broadly discussed and indicated as an example of creating efficient liability in corporate groups. There will be examination of an interesting legislation from Turkey, under which the shareholders of private limited liability company is proportionally liable for the companies’ debt owed to the state. Again there is an effort in Turkey to regulate corporate groups under the new draft commercial code. Moreover, as an alternative to case law, the approach of growing arbitration law to issue of corporate groups’ liability under the lights of arbitral awards will be examined. The author does not claim this study covers all examples from every jurisdiction, nor claims all the examples from the primary jurisdiction are included in this study because such a comprehensive study is beyond the limit and purpose of this research.

Developments Related to Corporate Groups’ Liability in England

In the UK, most regulations in relation to corporate groups have been introduced on an ad hoc basis in response to a specific problem or abuse, rather than in pursuit of any coherent legislative or regulatory strategy. In the UK Company Law, there are some provisions relating to the groups of companies but there is no section devoted to groups of companies, neither is there a particular group of companies’ law.

A number of Companies Act 1985 (CA) provisions require related corporations to be treated as if they are one with the parent company. Section 8(1) of the CA requires
the courts to lift the veil to determine whether a company is a holding company for the purposes of the Act, and section 269(8) of the Companies Act and regulation 57(1) requires the presentation of group accounts as consolidated statements in order to provide a true and fair view of group activities. There are some more examples of group statutory regulations: CA 1985 s 227 provides that parent companies have a duty to produce group account, which requires a parent company to prepare group account on a consolidated basis. This requires treatment of all the enterprises within a group as though they were one. Moreover, (CA) s. 231 provides that a parent company has to disclose details of subsidiaries names, country of activity and the shares it holds in the subsidiary. Moreover, some tax and employment legislations also follow the approach of considering group of companies. For example the Employment Rights Act 1986 protects employees’ statutory rights when transferred from one country to another within a group.

Insolvency Act 1986 provisions make the most significant impact on corporate personality and limited liability. Where the business of the company has been carried out to defraud creditors, the courts, on a winding-up, are entitled to look behind the veil of incorporation to find parties that know about the carrying-on of the fraudulent behaviour and are personally liable for the debts of the company. There are two principal devices that could be used to impose such liability for fraudulent trading and liability for wrongful trading under the sections of 213 and 214 of Insolvency Act (IA) 1986. The applications of the provisions on fraudulent and wrongful trading in the context of the parent-subsidiary relationship relies upon evidence demonstrating that the parent company exercises some degree of managerial control over its subsidiary. The limited liability of the parent is lifted either where the parent was knowingly party to the carrying on of its subsidiary’s business with intent to defraud creditors (IA s. 213 on fraudulent trading) or where the parent was the director or the shadow director of its

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insolvent subsidiary (IA s. 214 on wrongful trading). Although the section 213 on fraudulent trading covers almost all the circumstances in which a parent is engaged in the management of its subsidiary, it is subject to the very **strict requirement of establishing intent to defraud**. On the other hand, although the section 214 on wrongful trading is free from the evidential difficulties of the s. 213 it applies only in circumstances where the parent company is found to be the shadow director of its subsidiary and its independency might be removed by the interior organisation of the group.

The sections operate only when a company has gone to insolvent liquidation and declaration can be made only against a person who, at some time before the beginning of the winding up, was a director or shadow director of the company and knew, or should have decided, at that time, that there was no rational outlook that the company would keep from going into insolvent liquidation.

Although the Insolvency Act provisions requires very strict conditions similar to those required for veil piercing, they still constitute, as Professor Davies states, probably the most extreme departure from the rule in *Salomon‘s case* yet achieved in the United Kingdom. However, the requirements for a successful establishment of liability on parent corporations indicate that the IA can be considered just an enacted equivalent of the veil piercing principles in the case law. Therefore, it cannot be claimed as a successful piece of legislation to remove negative effects of limited liability principles in groups of companies’ context. Consequently, the criticism made for piercing the veil doctrine of being out of date and thus not practically functional can be repeated in evaluation of wrongful and fraudulent trading principles in the IA. The Act considers group of companies as simple vertical organizations as one entity applies control over

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135 Avgitidis, *Group of Companies*, p. 224 (n 96)
136 The term ‘shadow director’ is defined in section 741(2) of CA as a person in accordance with whose directions or instructions the directors of a company are accustomed to act.
137 Avgitidis, *Group of Companies*, p. 225 (n 96)
138 Davies, *Gower and Davies*, p.196 (n 41)
139 Griffin, *Limited Liability*, (n 6)
another. Therefore, it has failed to bring any advanced liability regime and it is impossible to bring one unless the statute adapts the modern structures and characteristics of group of companies.

This lack of breakthrough in statutes for group of companies leads us to search for what the new Companies Act 2006 offers. The new Companies Act should be examined through its preparation process, which has three stages; the first is consultation report from the Company Law Steering Group in 2000, the second is Draft Company Law Reform Bill in 2005 and final stage is Companies Act 2006.

Company Law Review Steering Group, Modern Company Law for a Competitive Economy

With a close look at the Steering Group’s proposals one can observe that the Steering Group see no advantage in imposing a fundamental regime on groups of companies. They simply believe that, from their words, that “(having a groups of companies’ law) would take away flexibility in the way business organise themselves and would strike at the limited liability basis for company law”.

As an alternative to a developed group of companies’ law, the Steering Group offered a view on the question of group liability in tort and also considered the question of accountability, in particular by suggesting some new methods of group governance based on the concept of an ‘elective regime’ for groups. They believe that the most productive way for reform is to adopt an ‘elective regime’ under which, in exchange for a guarantee by the parent company of the liabilities of a subsidiary and satisfaction of certain publicity requirements, the subsidiary should be exempted from the requirements (under the Companies Act) relating to annual account and audit. An elective subsidiary

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must fall within the definition of a wholly owned subsidiary under Companies Act. The Steering Group see little point in requiring all wholly owned subsidiaries to be included in this regime. Which gives corporate groups flexibility to join the elective regime or not.

The Steering Group discussed the various options for the nature of the guarantee by the parent. But their initial view is that there should be no requirement for a reciprocal guarantee whereby the elective subsidiary would also guarantee the liabilities of the parent, nor for a cross guarantee from one elective subsidiary to another. Either of these would have the effect of a form of pooling of assets and liabilities across the elective group. This might create the most efficient regime of liability for the group. Thus, the Steering group rejected a pooling of liability across the group as a whole by supporting the system of simple bilateral guarantees. The reason was that the system of bilateral guarantees is likely to prove simpler in practice and would avoid the possibility that the creditors of an elective subsidiary could be at risk because of liabilities arising in a sister elective subsidiary. The approach of Steering Group apparently indicates that they consider groups of companies as vertical organisations.

The proposed guarantee should work as a normal guarantee in that an unsatisfied creditor would take action against the elective subsidiary, joining the elective parent in the action. The Steering Group find joint and several liability of a parent inappropriate because of the fact that this would enable the creditor to sue the parent without suing the subsidiary, which is considered unacceptable.

In short, the most important problem of group of companies has been left with no solution in the proposal. The most problematic circumstances in which they regard it as entirely proper for a holding company to separate an activity by using a subsidiary total the risk of liability, includes tort liability because the Group claims many torts are closely linked with contractual liabilities, for example liability for professional services and misrepresentation and product liability. More interestingly, the Group founded the legitimacy of their findings on the fact that they are not aware of any jurisdiction providing for parent companies to be automatically liable for the torts or delicts of their subsidiaries. Thus, they claimed that defining the circumstances in which the use of
limited liability in this way is regarded as abusive would be difficult. Nor they are aware of cases where parent companies have engaged in such abuse. They find the easiest excuse and refer the problems to the insolvency law stating that the under-capitalisation of subsidiaries, and their operation in a way which creates undue risks of insolvency, are matters best dealt with by insolvency law. They concluded the proposal by saying that "We do not therefore propose any reform in this regard".

In particular, the proposal did not offer any fundamental or innovative regime. It simply stated that there is no regime offering these kinds of regulation in the world. However, their elective regime even falls short of the types of regime established 40 years ago by the German Stock Corporation Act of 1965. The only significance of the Steering Group's proposal is that, for the first time, reflection is being given to the question of whether English law should have a dedicated regime for groups of companies.

The regime Steering Group propose is just a reflection of pressure that current business apply on regulators and thus, contains many weak suggestions. First, there is no obligation for the parent to make an election. Moreover, it is applicable for only wholly owned subsidiaries. Secondly, the proposal is silent on whether election could extend to any subsidiary. This is completely in contradiction to the modern characteristics of the MNEs. The horizontal structure indicates that the groups of companies might include many wholly owned subsidiaries together with many partly owned subsidiaries. Moreover, there is a complex cross-ownership in corporate groups, which might result many sub-corporate groups within in a group. Thus, it is unreasonable to expect success for the elective regimes that covers only wholly owned subsidiaries without requiring parent to extend the regime to other subsidiaries. Moreover, allowing parents to make the choice will result a situation that is similar to

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141 The Act is examined below. (p 228)
142 Muchlinski, Holding Multinationals. (n 25)
143 Muchlinski, Holding Multinationals. (n 25)
the current situation that the groups is not considered as single enterprise but it is represented by many legal entities without necessarily creating any group liability.

The jurisdictional problems have been left completely untouched. The elective regime would apply only to EU based parent companies, but not to groups whose parent company is outside the EU. Failing to cover parents from outside the EU means failing to regulate MNEs originated in different jurisdictions. The parent might easily insulate itself by removing their assets to countries out of the EU. This is already common practice. For example in the *Multinational Gas*, the assets of the joint venture company in question were located in Liberia, while the main business operations were carried out in England through services-only companies.

The rejection of a pooling approach to the definition of the limits of assets available to claimants ignores a basic problem in mass tort litigation, where the economic activity of the group as whole is involved in the hazardous processes that lead to the harm causing the claims. Actually, it is common in commercial practice to ask for reciprocal guarantees when dealing with groups of companies. Thus, sometimes contractors with the group ask for guarantees from different companies under the group to secure their credit. However, the proposals refuse to create a reciprocal guarantee between the parent and subsidiary. The reason for this depends again on misunderstanding of the structure of corporate groups in business practice. The one-way guarantee is typical of the vertical understanding that was used in past experiences in case and statutory law and failed to create a satisfactory liability regime. The horizontal structure suggests that not only there should be reciprocal guarantee but also there should be a group guarantee for creditors of any subsidiary because even in the selection of the elective regime there is no guarantee that the parent will be asset rich. Thus successful proposals in this sense should have included pooling of assets, at least for the claims made by involuntarily creditors.

In conclusion, the proposal of an elective regime is frustrating for those who expected a regime at least better than the German Stock Corporation Act. It is
disappointing because it would definitely tempt manipulative corporate planning by
groups of companies by leaving them to decide whether to elect or not. Thus, the
Steering Group’s approach to corporate groups’ liability may fairly be described as a
major inadequate treatment of an issue of key importance in the reform of any system of
company law since dismissing the problem of subsidiaries’s laibilities by diverting it
into the uncertain future of insolvency law reform is deeply unsatisfactory. But, it is
logical to expect these kinds of regime because proposals are based on the lack of proper
examination of corporate groups.

Department of Trade and Industry (DTI), Company Law Reform Bill, the White

As the Steering Group unreservedly admits, its proposals are “not a radical recasting of
company law”, but it considers that these proposals are “a sensible reduction of burdens
in groups without weakening their existing position”. Therefore, it is not surprising that
the proposal by the DTI mostly depends on the suggestions and reports of the Steering
Group and has the preamble:

“The DTI derives our working ambition of ‘prosperity for all’ by working to create
the best environment for business success in the UK. We help people and companies
become more productive by promoting enterprise, innovation and creativity...We
champion UK business at home and abroad. We invest heavily in world-class science
and technology. We protect the rights of working people and consumers. And we stand
up for fair and open markets in the UK, Europe and the world”.

145 Boyle, The Company Law, (n 144)
146 DTI, Company Law Reform Bill, the White Paper (CM 6456, March 2005)
With the proposal all positive expectations have vanished, even the little ones that the Steering Group’s handling of the group of companies as at least a matter of consideration seem to have fallen on deaf ears. The objective of the DTI proposal is to maintain the UK’s position as one of the most attractive places in the world to set up and run a business. The draft Bill thus even does not mention the group liability problem so as not to scare the MNEs, which happily operate in the UK.

Accordingly, there is a huge contradiction in both the Steering Group Report and the government’s White Paper, by claiming they aim to create future company law for the country but they just ignore the phenomenon of MNEs that seems the most important feature of the current and future issues of company law. The DTI proudly announced that they are innovative but in terms of creating pioneering law they refer to the non-existence of laws in other jurisdictions. Thus, it can easily be claimed that they are innovative in the fact that they can pretend there is no problem in a situation that the discussion of liability is intense and call for better regulation is more organised. As a result, the New Companies Act 2006 based on these principles does not offer any solution in this matter.

The present idea of this thesis is not only to indicate the liability problems of groups of companies and particularly MNEs but also, assuming that the existence of the problems is not in dispute, the thesis aims to test the suitability of the current laws and proposals or discussions on the issues to new economic and organisational realities of the MNEs. Unfortunately, the New Companies Act offers no changes, thus, with huge disappointment I want to turn my attention to the developments in the EU regulations.
European Company law recognises that a corporation is a separate legal entity and thus must have legal personality. This rule applies not only when the shareholders are natural persons, but also when the shareholders are corporations. Accordingly, under the traditional European Company Law, a member company in a group cannot be required to satisfy the obligations of another member company in the group. Because of the settled rigid principles of limited liability in the member states and Union company law itself, the European Union has not achieved a comprehensive corporate group liability regime. The efforts to produce fact specific groups of companies' directive have collapsed. Consequently, there is no basic principal for liability for corporate groups in the EU. The community rather defines and uses several notions of the group enterprise to be applied in various domains for different regulatory purposes. Starting from the Seventh Company Law Directive and by various other legal provisions, such as banking, insurance and anti-trust law, groups of companies have attracted some sort of regulations.

The European Community has refrained from extensive uniform approaches to particularistic technical changes that can be integrated within the member states. Thus, traditionally core areas of company law remain largely untouched by harmonisation. Particularly creditors' protection against corporate groups remains a

147 Bakst, Piercing the Corporate Veil, (n 53)
148 Bakst, Piercing the Corporate Veil, (n 53)
149 Irujo, Trends and Realities, (n 7)
151 For example, articles 85 and 86 of the Treaty of Rome refer to undertakings, which are accepted to be a much wider and looser concept than the English concept of separate individual corporate personality under Salomon. The provisions apply to parents and subsidiaries -even when not wholly owned.
152 Sugarman D, 'Corporate Groups In Europe: Governance, Industrial Organisation, And Efficiency In A Post-Modern World' in Sugarman D and Teubner G (eds.), Regulating Corporate Groups in Europe (Baden-Baden, Nomos 1990)
matter of national law. Indeed, the EU intervention in some areas, instead of creating a common legal environment, has probably made the law more complicated. The changes that have taken place have often made it more difficult for a resident of a member state to know what the situation is with her own legislation while doing little to inform her about what the law is in other EU countries. Thus, implementation of individual legislative and procedural laws on corporate groups is still inadequate in most European countries. 

However, the EU institutional law at least in theory is more advanced than the English approaches because it can be claimed that at the EU level, there is a wider acceptance of the problems created by the group of companies. Therefore, it is not surprising that there have been some ongoing efforts to create better regulations for the corporate groups, even though many of them had failed even before reaching at a proposal level. Moreover, it is a common practice in the EU to consider groups of companies in the processes of preparations of new legislations. For example, the Cross Border Merger Directive would fill an important gap in company law and is the first measure to be presented under the Commission’s Action Plan on company law and corporate governance in the European Union. In Article 14 of the Merger Directive, which has a title of ‘consequences of the merger’, it is regulated that the acquiring company will be liable for acquired company’s obligations.

The original proposal for a European Company Act (SE) contained provisions similar to those of the German Stock Corporation Act, which would permit the management of the group as a single economic unit. It proposed (article 239/1) that the controlling company of a concern shall be liable for the debts and liabilities of its

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154 Irujo, Trends and Realities, (n 7)
156 German Stock Corporation Law is examined below. (p 228)
dependent subsidiary companies. A parent company was presumed to control its subsidiary, and the subsidiary was presumed to be dependent on parent. The parent could invalidate this presumption if it established a proof that it restricted itself to a mere passive shareholder role. Additionally, the Ninth Company Law Directive on the Conduct of Groups Containing a Public Limited Company as a Subsidiary had provisions, as one of its proclaimed goals, to grant adequate protection to subsidiary creditors where their primary debtor is dependent on a parent company. However, at present, neither proposal has been adopted.

The failure of those attempts put new efforts in jeopardy for some time. Only in recent times and in connection with the Forum Europeaum has group regulation again caught the attention of the European Union. Following the Winter Report, the recent Company Law Action Plan makes special reference to the corporate group phenomenon, although from a less ambitious perspective than that of the Ninth Directive. Thus, this thesis will discuss recent attempts rather than discussing of already failed attempts.

Winter Report, High Level Group of Company Law Experts and Action Plan on “Modernising Company Law and Enhancing Corporate Governance in the EU”

The Action Plan is the Commission’s response to the final report, presented in November 2002, of the High Level Group of Company Law Experts chaired by Japp Winter. The Commission of the European Communities in its Communication and Action Plan set the principles that the plan for company regulation must be “flexible in application, but firm in the principles”. The main objectives of the Action Plan are: 1- to

158 Hofstetter, Parent Responsibility, (n 126)
159 Bakst, Piercing the Corporate Veil, (n 53)
160 Irujo, Trends and Realities, (n 7)
strengthen shareholders’ rights and protection for employees, creditors and the other parties with which company deal, while adapting company law and corporate governance rules appropriately for different categories of company. 2- to foster the efficiency and competitiveness of business, with special attention to some cross-border issues.

In relation to corporate groups, the Winter Report states that the existence of risks in the groups of companies challenges neither the legitimacy of groups nor the limited liability principle. Thus, the Report supports the view that the enactment of an autonomous body of law, specially dealing with groups, is not recommended at EU level, but that particular problems should be addressed in three areas: transparency issues, consolidated approach to group policy and bankcruptcies, and abusive pyramids. As a result, the Winter Report states the need for legislative intervention on corporate groups through three basic issues: 1- the transparency of the group structure and its relations 2- the tension between the interest of the group and that of the group members and 3- the special problems of pyramid structures.

Accordingly, the Report has made some general recommendations. First, they agree that there is no need to revitalise the dead Ninth Company Law Directive. Second, increased disclosure with regard to a group’s structure and relations is needed, and the parent company of each group is to be made responsible for disclosing coherent and accurate information. These improvements can be managed by increasing disclosure requirements in the 7th Directive. Third, the commission should review the possibility of introducing in Member States rules on procedural and substantive consolidations of bankruptcies of group companies. Finally, the EU should require national authorities, responsible for the admission to trading on regulated markets, not to admit holding companies whose sole or main assets are their shareholding in another company, unless the economic value of such admission is clearly demonstrated.


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The commission published its Action Plan based on the evaluation of the Winter Report. Here, only issues relating to liability of groups of companies will be discussed. The commission has agreed with the Winter Report on the view that there is no need to revive the draft Ninth Directive on group relations. The commission did not want to be in deadlock again and thus created a plan, which is less comprehensive than the Ninth Directive.

The Commission acknowledges the fact that groups of companies are a legitimate way of doing business, but they may present risks for shareholders and creditors. Although they apparently accepted the fact that creditors need protection, in terms of offering solutions they have failed to create fundamental principles. They recommended that more transparency could help minimise those risks. Initiatives aiming at improving the financial and non-financial information disclosed by groups are priorities for the short term. Such initiatives would aim to ensure better information on the group's structure and intra-group relations, as well as on the financial situation of the various parts of the group. Moreover, the action plans supports a framework rule to allow those managing a company belonging to a group to implement a coordinated group policy. Fortunately, it emphasises the need for action against abusive pyramids defined by the High Level Group as chains of holding companies whose sole or main assets are their shareholding in another listed company. Accordingly, the Commission has concluded its Action Plan for groups of companies dividing the actions in three phases, short term, medium term and long term.

Firstly, in the short-term, the Commission intends to adopt legislative measures with the intention of improving the group disclosure of financial and non-financial information. Since transparency is felt as the most urgent problem in corporate groups context, whether they are listed or not, the commission regards these additional initiatives as priorities for the short term.

Secondly, the Commission aims to come forward in the medium term for a proposal directive providing a framework rule for groups allowing adoption of a coordinated group policy. The Commission also points out that with coordinated group policy the interests of company's creditors are effectively protected. Commission does
not make any differentiation between voluntary and involuntary creditors under coordinated group policy. However, the Commission has not followed the recommendation of the Winter Report that the issue of introduction rules on procedural and substantive consolidations of bankruptcies of groups of companies in Member States. Thus, positive approaches taken by the Winter Report have been disregarded by the Commission. Examination of modern structural characteristics of MNEs indicates different realities since most groups already have improved organisational structure with different nature of control than the Commission suggest. Thus, expecting corporate groups to extend their control over their subsidiaries by adopting coordinated group policy, while managerial theory forces them to adopt an organisational structure which gives more independence to subsidiaries does not reflect the interdisciplinary characteristics of groups of companies. This situation is a result of Commission’s consideration of group of companies as simple vertical organisation.

Thirdly, the commission intends in the medium term to give further consideration to the risk inherent in abusive pyramids and, if necessary, make a legislative proposal to prohibit them from stock exchange listing.

As a result, the Winter Report and Commission Action Plan have failed to determine the important characteristics of groups of companies. The recommendations in the Action Plan are too shallow to create fundamental changes in the area of corporate groups’ liability in Europe. It seems that in the short, medium and even long terms there is no intention to regulate the liability issues in the groups of companies. Under those conditions it is impossible to discuss EU law’s approach to MNEs since the group of companies law in Europe does not offer anything fundamental. As a result, apart from the aforementioned formulation of basic principles (recognition of the group’s interest and protection of external shareholders and creditors), the European Union has little room for progress on this subject.

Thus, the positive approach taken by the EU by recognising problems created by groups of companies turned to be negative when it reached at Action Plan level. The Union has taken very practical approach to groups of companies’ problems and tried to find solutions for practical operational problems of groups. Thus, they have ignored the
substantive problems of liability. The Action Plan does not touch any problems that might create a huge debate in member countries. As discussed earlier, the issues of MNEs liability have international characteristics and thus require more coordinated approaches by countries. The EU in this sense has many advantages in terms of creating a law, which can be applied in countries, in which together reside huge number of MNEs.

The EU should therefore create another action plan in terms of corporate group liability covering MNEs as well. The new plan should consider the interdisciplinary realities of MNEs. Accordingly, the new plan should aim to recognise the fact that MNEs might create problems when operating in their modern structure. Therefore, the plan should disassociate itself from the mistakes made by previous regulations in member states. Rather than bringing different approaches in member states, the Union should go for innovative solutions and thus create a realistic corporate groups law that consider MNEs as horizontally structured organisation.

Corporate Group Law of Europe, the Forum Europaeum

The forum emphasises that corporate groups are a reality of life. Similar to the Action Plan, the Forum acknowledges the problems and seeks to clearly establish the legitimacy of the corporate group as a legal institution, as well as recognition of its interests and the exercise of management power by the entity controlling the group. The forum, like the Commission, recognises that the two most important objectives of corporate group law are the protection of creditors and minority shareholders of subsidiaries. As a way to

162 The Forum Europaeum Konzernrecht consists of a steering committee. Together with many other European academics, the committee conduct the project “Konzernrecht fur Europa” (Corporate Group Law for Europe). In this article The Forum Europaeum makes proposals to the European and national legislatures for addressing the common problem of corporate groups in Europe. Forum Europaeum Corporate Group Law, Corporate Group Law for Europe (2000) 1 EBOLR 165
achieve this, the forum has taken up the Rozenblum doctrine,\textsuperscript{163} which has been created by the French High Court. According to the doctrine, recognizing the interests of the group requires the practical confirmation of the existence of a solid entrepreneurial structure, a coherent group policy and internal balance between the burdens and advantages.\textsuperscript{164}

The forum claims that there is already a kind of harmonisation of corporate groups in the Union under the rules of banking, insurance and the Seventh Directive on Consolidated Annual Accounts and many other individual laws which affect groups of companies. However, the forum aims to limit the proposal just for company law excluding other branches of the law (environmental, labour, insolvency, tax). This positive approach to the problem of corporate groups is very important. The forum understands the complexity of scattered regulations under different branches of the law. In other words, the forum suggests that if there is a well structured law that abolishes the limited liability principle and impose liability on every each member of the group, there will be no need for these complex regulations.

Therefore, the most important characteristic of the Forum’s proposals is that there is an urgent need to regulate corporate groups at the Union level as well as reflecting these regulations in Member States. The forum indicates that harmonisation must cover core areas of corporate law in the Union. It must create basic principles of groups of companies’ regulation so it must leave some empty space for member states. Aiming a regulation at the Union level is a very positive step. Thus, the forum at least in principle offers something braver than the Winter Report.

\textsuperscript{163} Forum Europaeum, Corporate Group Law, (n 162). Accordingly, three conditions must be fulfilled in order that the interest of the subsidiary can be legitimately subordinated: firstly, the group structure must be firmly established; commercial activities of the companies in the group must be interrelated in such a way that they exercise negative as well as positive influence on each other. Secondly, a coherent policy for the entire group must be in place; the requirement of group policy presupposes the existence of one inclusive overall group policy for the group as a whole. Thirdly, the advantages and disadvantages for each company must be properly distributed within the group so that a balance is maintained.

\textsuperscript{164} Irujo, Trends and Realities, (n 7)
On close examination of the Forum's proposal, the proposed rules by the Forum will be based on the concept of 'control' within the meaning of Article 1 (1) and article 2 of the Seventh Directive. Under the articles, one company controls another company if it has a majority of voting rights, has the power to appoint or remove a majority of the members of the board of directors or the supervisory board, or has the right to exercise a dominant influence pursuant to a contract entered into with the controlled company or pursuant to a provision in the controlled company's constitution.

The Forum Europeaum proposes that the EU should legitimize in all member states groups which are organised on an EU market-wide basis and thereby ensure that such groups as a whole and their subsidiaries operate on a solid legal basis. The forum consider the French 'Rozenblum' formula part of EU law must, in many respects, be merged with the law of each Member State, which must regulate the penalties to be imposed in case of non-compliance.

In the issue of the legal recognition of group management, the French Rozenblum concept makes it possible for the management of subsidiary companies to subordinate the subsidiary to the interest of the group upon the fulfilment of certain conditions. Consequently, under this formula, as set out in the Draft Directive of the Forum Europeaum, directors of a group company can act in the interests of the overall corporate group, and subordinate or sacrifice the interest of their own company, if: 165 1-The corporate group has a balanced and firmly established structure; 2-The company took part in a long-term and coherent group policy, and 3-The directors in good faith reasonably assumed that any detriment suffered by their company would in due course be made good by other advantages.

In return for making use of this option of operating as a group, the company is not required to sacrifice the legal independence of its subsidiaries. Rather, the parent would be required to assume the liability for the commercial risks of subsidiary. 166 Approval by

166 Forum Europeaum, Corporate Group Law, (n 162)
the general meeting of the parent is a precondition for a legally effective group declaration. In addition to the entitlement of the parent to direct the management of the subsidiary, the legal consequences of the group declaration include the assumption by the parent of liability for losses incurred by the subsidiary in case of winding-up (creditor protection) and the obligation to compensate the minority shareholders in the subsidiary (minority shareholder protection). The special characteristic of the Rozenblum concept is that it does not, compared to German law, oblige the parent company to provide precise compensation for every disadvantage inflicted on an individual subsidiary. However, the obligation of the parent does not come into force at the end of the financial year, in opposition to the German Stock Corporation Law, but only: 1-on the opening of insolvency proceedings against the subsidiary, or 2- the effective revocation by the parent of the group declaration. Therefore, the liability is not a direct liability but a secondary liability because the parent liability occurs if only subsidiary gets bankrupt or the parent revokes the group declaration.

The only direct liability of the parent company occurs in favour of the subsidiary’s creditors only if the parent is considered as a shadow director. If the criteria for such requirement are not met, then the parent is not required to take any action to rescue the subsidiary, or to accept liability for its debts. In summary, whereas the parent may be motivated to rescue a subsidiary, it has no obligation to do so. This means that the Forum Europeaum proposes an obligation on a parent company either rescue or wind up a subsidiary company that has reached ‘crisis point’, that is, where the subsidiary has ‘no reasonable prospect’ of avoiding insolvency through its own resources. A holding company, which fails to act in these circumstances, would be liable for any consequential losses of the subsidiary. An alternative proposal is to impose this liability only where a parent company has exercised actual control over the subsidiary.

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167 Forum Europeaum, Corporate Group Law, (n 162)
168 Forum Europeaum, Corporate Group Law, (n 162)
169 Kluver, European And Australian Proposal, (n 165)
Here, one can compare the proposed wrongful trading rules to the general idea of the English 'wrongful trading' rules, which regulates that if the directors ought to foresee that the company cannot continue to pay its debts, they must decide either to rescue the company or to put it into liquidation. Otherwise, the directors will be liable fully or in part to creditors for their unpaid claims. The concept of wrongful trading applies both to independent companies and to companies within the groups. The directors of a subsidiary company are subject to the rules, as well as the parent company and its directors if they operate as de facto or 'shadow' directors of the subsidiary.

An extensive study on corporate groups should come with more complicated and advanced group liability regime. However, interestingly, the forum fails to create a more advanced liability regime for corporate groups. Rather they copy the regimes already proven ineffective due to misunderstandings of the managerial structure of the groups. Even though, the Forum’s proposal and the Rozenblum doctrine require group to have group structure and operate according to their group policy with balanced distribution of benefits and burdens amongst companies, the liability proposed is still parent companies liability. And it is not a direct liability of the parent but just is a secondary liability. Only direct liability is proposed in case of wrongful trading and is based on the excessive control of the parent over its subsidiaries.

Accordingly, the Forum fails to absorb contemporary characteristics of MNEs into its proposals. The liability proposed is parent liability and the relationship between the subsidiary and the parent is considered as vertical rather than horizontal. Thus, the parent is primarily responsible for subsidiaries debts in certain condition of close control. In reality the structures of corporate groups are more complex and control applied by the parent over its subsidiaries is not that simple. There is a complex cultural control in corporate groups that requires more independence for subsidiaries from the parent but more integration as group by embracing other entities. Under these conditions, it is unrealistic to expect MNEs to undertake operational structure suggested

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by the Forum since is not suitable for the most efficient managerial structure. Moreover, the liability based on wrongful trading depends on certain conditions that are very difficult to prove under the modern structure.

As a general idea, the Forum's work is useful to emphasise the scale of corporate groups in the modern business world. It once again points out the differences from the legal model of the single and unattached company. However, the forum completely lacks innovatory proposals because all the typical missing points discussed earlier appear in the Forum's proposal as well; there are no special regulatory provisions for involuntarily creditors. Moreover, there is no attempt to create special regulation for MNEs. Under these conditions, the involuntarily creditors protection against MNEs is completely unfilled. Even though the Forum suggests a need of unified regulation in case of cross-border problems, they just ignore the problems by not considering problems MNEs create. In particular, it is not clear what happens if the law governing the subsidiary, the supposedly protected part, does not provide for the group declaration or states different rights and obligations compared to the parent's law. Similarly, the substantive law with the possible international private law questions are not discussed.172

The overall evaluation of Forum's proposals suggests the Forum fail to produce something new and evolutionary. The proposals are rather a mixture of legal principles developed in different jurisdictions in the EU to prevent abuses of groups of companies. Rozenblum from France, wrongful trading from England and qualified groups from Germany have been mixed. Thus, one can easily claim that, after the unsuccessful Ninth Directive, the participants thought it would be more likely to reach agreement if they can manage to bring together principles developed in basic jurisdictions in Europe. However, it should not be forgotten that the legal principles in one jurisdiction are always attractive to the professionals in other jurisdictions i.e. the French doctrine of

171 Final Report On The High Level. (n 170)
Rozenblum and English doctrine wrongful trading have been criticised by many academics from these jurisdictions.173

Approaching the issues with a more general perspective reveals that the substantive liability proposal of the Forum should be read in the light of the concept of ‘control’. In the extensive examination of MNE structure it has been proven that the concept of control in corporate groups is different from the way it is perceived in legal studies.174 The Forum is under the common misconception of corporate groups since they never mention horizontally structured enterprises. They are unaware of the modern conception of the corporate groups. Moreover, case law examination apparently proves that founding liability on the basis of control is unsatisfactory. Thus, basing the new liability proposal on the control principles is a mistake and the life of the proposal will be short unless the forum considers the modern managerial structure of MNEs in creating corporate groups.

European Competition Law litigation; Group as Single Economic Unit

One should expect more fundamental and up-to-date development in competition law because of the multi-disciplinary characteristics of the anti-trust issues. Consequently, the emerging law of the European Community Competition Law represents one of the most recent attempts to legislate on groups of companies for anticompetitive behaviours. As a principle, where a subsidiary is wholly owned by its parent company and it is found as a matter of fact that the subsidiary is not able to engage in economic action that is autonomous of its parent company, then in spite of their separate legal identities, the two companies will be regarded as one for the purposes of EC competition law.175

173 Windbichler, Corporate Group Law, (n 172)
174 Detailed discussion is made at chapter 2.
175 Bakst, Piercing the Corporate Veil, (n 53)
In the cases of *Centrafarm v Sterling*¹⁷⁶ and *Viho Europe BV v Commission of European Communities*¹⁷⁷ the European Court of Justice decided that where a company and its subsidiaries are formed as a single economic unit, the subsidiaries cannot enjoy any real autonomy in determining their operations. Consequently, the most established basis in EC competition law for asserting jurisdiction over foreign companies is the doctrine of the group as a ‘single economic unit’. This doctrine features the foreign parents’ responsibility for the anti-competitive activities of a subsidiary that is present and active in Europe and over which they supposedly exert some control. Owing to the **supposed control** that the parent can exert and should have exerted over the subsidiary, the parent, and other relevant members of the group may be brought within the jurisdiction of European Law.¹⁷⁸ The court has emphasised the corporate structural relationship between the parent and the subsidiary and merely considered the parent’s **ability to control** the latter, rather than whether that control was actually exercised.¹⁷⁹

The court ruled that “*the fact that a subsidiary has separate legal personality is not sufficient to exclude the possibility of imputing its conduct to the parent company... in the circumstances, the formal separation between these companies, resulting from their separate legal personality, cannot outweigh the unity of their conduct on the market for the purposes of applying the rules on competition*”.¹⁸⁰ Accordingly, the ECJ held that where a subsidiary does not enjoy real autonomy in determining its course of action in the market, the prohibitions set out in article 81(1) of EU Treaty might be considered inapplicable in the relationship between it and the parent company with which it forms one economic unit.¹⁸¹ The application of single economic unit theory in EC competition judgement requires certain conditions. First of all, the parent and

¹⁷⁶ *Centrafarm v Sterling* 1974 ECR 1147

¹⁷⁷ *Viho Europe BV v Commission of European Communities* (Case C-73/95P)


¹⁷⁹ Goyder, *EC Competition Law* p. 500 (n 178)

¹⁸⁰ *Centrafarm BV v Sterling Drug Inc.*
subsidiaries should form an economic unit as explained in *Viho* "an economic unit with in which the subsidiary has no real freedom to determine its course of action in the market because the parent company permanently supervises the making of decisions by, and the administration of, its subsidiary. Secondly, the agreements must be solely intended to carry out internal allocation of tasks as between the undertakings".\(^{182}\)

The examination of the principles indicates that, the requirements can only be met by the vertically organised corporate groups because clear control established by a parent over its subsidiaries is apparent only in such groups. The examination of the group subjected to the judgment in *Viho* case indicates that the Parker Pen Ltd. controls and is involved in decision making in its subsidiaries in Belgium, Germany, the Netherlands, France and Spain. The parent controls its subsidiaries and key decisions are taken by the parent. For example the parent limits the subsidiaries' area of operations to their own jurisdiction. The examination of other cases indicate similar characteristics that corporate groups brought under the judgment of the ECJ for constituting single economic unit have characteristics similar to vertically organised corporate groups. Accordingly, in the cases, there was a control or supposed control by parent over its subsidiaries and there was a one-way parent liability for this control.

Thus, the analysis of competition case law demonstrates that the single economic entity theory applied in anti-trust cases by ECJ has some similarities of veil piercing doctrine.\(^{183}\) In the cases, the separate legal personality of the Community subsidiary is ignored in order to reach its corporate shareholders. However, the single economic unit argument in the EU competition law has more advanced features in comparison to the veil piercing theory in two aspects. First, the required nature of control in the group of companies is less strict than that required level in veil piercing cases because the Court looks for supposed control rather than actual control of the parent. This makes imposing

\(^{181}\) The group economic unit concept was confirmed in cases *Centrafarm BV* v. *Sterling Drug Inc.* and *Instituto Chemioterapico Italiano and commercial Solvent Corporations* v. *Commission cases 6-7 73 [1974] ECR 223

\(^{182}\) *Viho Europe BV*

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liability on the parent company easier and more often. The second point is the applicability of the anti-trust ruling on foreign parent companies; the policy in the EU is to extend the applicability of competition rules to companies outside of the jurisdictional barriers of the EU.

However, it seems that this relatively flexible approach is only considered in competition rulings and the single economic unit argument does not ignore the separate personality of the companies under the group. It rather establishes supposed liability on parent because of the difficulty of proving the independent economic decisions by the subsidiary in the common economic policy of the group. However, in the supposed control theory, it is always possible to escape liability by proving that there was not control over subsidiary by the parent. Accordingly, the liability regime that is designed according to a belief in a sharp and vertical control theory in corporate groups cannot be applied to complex structure of MNEs under which there is a horizontal organisational structure and cultural control.

European Union: Adding More Complexity to the Problem

Given the urgency of the liability problems in MNEs activities, the EU, in the interest of involuntarily creditors, should recognise corporate groups as a modern organisational form and take them out of the grey area of mere complexity. The regulation of groups of companies in certain areas of practice in order to solve very specific problems does not create a required level of tort liability in corporate groups. Moreover, not having inclusive recognition of the groups might cause regulatory competition amongst the member states. The mistake of the Union is that during the period of attempts to regulate, it seemed to prefer a corporate group law based on the formulation of major standards, leaving precise features relating to the formation and operation of corporate

183 Schenck Daniel W, ‘Jurisdiction over the Foreign Multinational in the EEC: Lifting the Veil on the
groups to the member states or, where applicable, to self-regulation.\textsuperscript{184} Exposing the company to different legal requirements or differentiated extent of liability according to the laws of the individual member states only complicates and endangers the rights of all creditors at the European level.\textsuperscript{185}

Moreover, the contents of regulations in the Union are too shallow and exclude many basics. The discussions prove that from the beginning, including the Ninth Directive, attempts have failed to provide satisfactory solutions. The Commission’s Action Plan and even specific study of the Forum Europeaum have failed to address the problem of MNEs liability even they have failed to articulate the problems. This failure to articulate problems has prevented interdisciplinary approaches to groups of companies’ problems. Therefore, the discussions still concentrate on the control theory.

The deadlock of the control theory, certain degree of control over the subsidiary imposed by the parent, has not been overcome by any law or proposal at the European level. The Winter Report, the Action Plan and Forum Europeaum fail to spot that when a regulatory work is based on the idea of control, there is always possibility to avoid tort liability since the reality of corporate group structure is not exactly as simple as to be covered by the control theory.\textsuperscript{186} There will be huge obstacles to enforcing liability in horizontally organised groups and in case of MNEs it will be almost impossible to make them accountable for their torts.

The misconception is still very common that groups of companies are vertically organised groups that the parent controls subsidiaries and they operate under the common policy of the parent. For this reason, in the short term, the possibility of development of group’s notions at Community level appears to be linked to the adoption of measures of general application containing some specific provisions to be applied to

\textsuperscript{184} Irujo, Trends and Realities, (n 7)


\textsuperscript{186} Detailed discussion is made at chapter 2.
vertically structured enterprises.\textsuperscript{187} And none of these specific provisions seem to be solving liability problems. As a result, because of this common belief of corporate groups as vertical, the legislators, courts and scholars cannot produce better proposals for establishing liability other than liability based on \textit{control theory}. However, the reality is much more complex in a horizontal organisation; the control is completely spread over the subsidiaries and replaced by more common group policy and principles.\textsuperscript{188} Companies operate according to policies of the group even in some occasions with no instruction from the centre. In case of a need for direction, the subsidiaries might refer to the parent or sub-parents or other specialised subsidiaries on particular policy creating such as, advertisement, information technology, finance, and insurance.\textsuperscript{189}

Therefore, it is obvious that being in a group means operating under a complex structure of cultural control and common group policies. Thus there is no particular need to develop a theory that requires many more non-provable conditions in order to make parent companies liable. The European legislator should restart the future efforts from this innovative approach and new proposals should cover national, union based and multinational enterprises since there is barely another field of law that is better suited for a common European development by jurisprudence than the law of groups of companies. Moreover, since groups of companies are operating to a great extent across the barriers of national borders, no national legislation has yet found a complete system but in all of them there seem great public demand for regulation, which can be trigger to develop a common group of companies’ law of Europe.\textsuperscript{190} The regulatory concept must cover protection measures against a misuse of subsidiaries established abroad. This issue of protection of people from hazard of MNEs under the basis principles of the European

\textsuperscript{187} Adinolfi, The Legal Notion, (n 150)
\textsuperscript{188} Detailed discussion is made at chapter 2.
\textsuperscript{189} Detailed discussion is made at chapter 2.
\textsuperscript{190} Lutter Marcus, ‘The Law Of Groups Of Companies In Europe’ (1983) 1 Forum Internationale p. 1
rules must not be ignored.\textsuperscript{191} Tort creditors could thus be identified as eligible for general interest status at the EU level from the public policy aspects and thus, a form of protection must be built to defend their interests.\textsuperscript{192}

\textbf{German Stock Corporations Act, 1965}

Unlike the most other systems, German law has a specific set of rules applicable to groups of companies. These rules are contained in the Stock Corporations Act of 1965. Articles 15-19 define different form of the enterprise connection and articles 291-337. contain the substantive provisions. The law on groups of companies deals with the balancing of interests in situations where one enterprise controls the business policies of one or more other enterprises, by directly or indirectly influencing the management of the controlled enterprises.

A group is formed either when a controlling and one or more dependent enterprises are combined under a \textit{uniform management of the controlling enterprise} or when enterprises which are legally and factually independent of each other come under \textit{uniform management}. It is presumed that a dependent enterprise forms a group with the controlling enterprise.\textsuperscript{193} The concept of controlling influence and uniform management are not defined in the statute. In general, it is considered that an enterprise is in a situation to exercise a controlling power if it has authority to make another enterprise comply with its wishes; methods used for this purpose are irrelevant. The controlling influence may be capable of being exercised either by means of major participation in the dependent enterprise or by means of a control contract or by means

\begin{thebibliography}{99}
\bibitem{} Haar Brigitte, ‘Piercing Veil And Shareholder’s Product And Environmental Liability In American Law As Remedies For Capital Market Failures-New Developments And Implications For European And German Law After Centros’ (2000) 1 E.B.O.L.R 317
\bibitem{} Lombardo, Conflict Of Law. (n 185)
\bibitem{} Avgastidis, \textit{Group of Companies}. p. 189 (n 96)
\end{thebibliography}
of the power to control the composition of the management board of the dependent enterprise or by means of the fact that the boards of both enterprises are essentially composed of the same persons.\textsuperscript{194} The law divides corporate groups into three classes: integration concerns, contract concerns and de facto concerns.

**Integration concerns:** where a parent holds between 95 to 100 per cent of the stock of a subsidiary, the two companies can agree to integrate officially. The integrated group consists of a parent and wholly owned subsidiaries, which agree to subject themselves formally to the uniform management of the parent that, in exchange, becomes responsible for all their obligations. The chief company is liable to the creditors of the integrated company, jointly and severally, for all its debts and obligations arising before or after the combination. An agreement to the contrary has no effect against third parties. Even though the integration concern has no practical importance, its liability concept has been praised because of its crucial effect that removes the limited liability of the principal enterprise for the obligations of the integrated enterprises. Unlimited liability is the price that the parent has to pay for its unlimited power to direct the operations of the subsidiaries because the parent assumes this liability merely upon integration, without any further requirement.\textsuperscript{195}

**Contractual concerns:** the expectation before enactment of the law was that corporate groups linked through control agreements would become the most popular form of corporate groups because control agreements are the only legal way for a parent to acquire broad managing power over its subsidiary corporations.\textsuperscript{196} In practice though, control agreements have been rarely used.\textsuperscript{197}

A control contract is usually concluded between a controlling enterprise and one or more enterprises, which are dependent on it. Contractual groups are combined on a basis

\textsuperscript{194} Avgitidis, *Group of Companies*, p. 230 (n 96)
\textsuperscript{195} Avgitidis, *Group of Companies*, p. 232 (n 96)
\textsuperscript{196} Dine, *The Governance*, p.59 (n 23)
\textsuperscript{197} Assmann H. ‘Microcorporatist Structures In German Law On Groups Of Companies’ in Sugarman D and Teubner G (eds) *Regulating Corporate Groups in Europe* (Baden-Baden, Nomos 1990)
of a contract of domination whereby a firm subjects itself to management by another. The contract of domination thus changes the organisational structure of the now dependent firm.\textsuperscript{198} This broad authority of the controlling enterprise in directing the controlled is balanced by the principal enterprise’s obligation to compensate the dependent for every annual loss, which has occurred during the term of agreement.

However, the nature of liability is not a direct liability so the creditors of the dependent enterprise have no right of action against the controlling enterprise but they can enforce the compensation claim against it in accordance with the powers given to them by the Civil Procedure Rules.\textsuperscript{199} Because of this complex nature of the contractual concern, the contracts were very few as very well described by the great majority of the courts and commentators; parent corporations have “chosen relationship without marriage certificates”.\textsuperscript{200}

**De facto concerns:** as in general practice all over the world, most German parent and subsidiary companies are merely linked through stock ownership so majority stock ownership generates the presumption that subsidiaries are dependent on their parents. Thus, article 311(1) provides that in the absence of an integration or a control contract, a controlling enterprise may not use its influence to cause a dependent corporation to enter into any transaction, to cause it to take or refrain from taking any measure that are damaging unless adequate compensation is made to the dependent corporation.\textsuperscript{201}

According to article 317, where the controlling enterprise fails to compensate the dependent for any imposed disadvantages by the end of the fiscal year, the controlling enterprise and the responsible legal representatives become jointly and severally liable to the dependent for any loss.\textsuperscript{202} However, art. 317(2) provide an exemption from liability; if it is established that an orderly and careful manager of an independent company would

\textsuperscript{198} Assmann, Microcorporatist Structures, (n 197)
\textsuperscript{199} Avgitidis, *Group of Companies*, p. 234 (n 96)
\textsuperscript{200} Avgitidis, *Group of Companies*, p. 234 (n 96)
\textsuperscript{201} Assmann, Microcorporatist Structures, p. 347 (n 197)
\textsuperscript{202} Avgitidis, *Group of Companies*, p. 235 (n 96)
also have entered into a similar transaction or taken or omitted to take the same measure.\textsuperscript{203} Therefore, in order to establish liability under these provisions a plaintiff must prove not only that a controlling enterprise exercised a damaging influence over the management of the dependent corporation, but also the extent of any loss or injury incurred by the dependent corporation as a result of the detrimental influence and the absence of adequate compensation on the part of the controlling enterprise.\textsuperscript{204} Consequently, as Hofstetter defines, these provisions are a dead letter since successful actions for damages under them are apparently unknown.\textsuperscript{205}

**Qualified de facto group:** Since the German Stock Corporations Act turned out to be ineffective in various aspects, most notably as regards the provisions for *de facto* concerns, in the area of parent liability, the German Federal Court has articulated special rules so-called ‘qualified *de facto* concerns’ which is a corporate group structure in which the parent, as a sole shareholder, applies a *long-lasting and persistent control pattern* over the relationships of its subsidiary. In a qualified de facto group, a private limited company is subject to continuous and comprehensive influence in management matters by the dominating enterprise which has an enduring disadvantageous influence on the dominated company’s own interests. There has to be fact specific inquiry to prove controlling interest.

Consequently, the qualified concern is a relatively efficient German corporate-parent liability model because where the boundary between the parent and its subsidiary corporations becomes so intense as to make them inseparable to outsiders, there is a fictional belief that subsidiary has no real mind to control itself. Thus, in case of damage to subsidiaries’ creditors, the burden of proving that there is no damaging influence on the subsidiary by this dominant control shifts to the parent.\textsuperscript{206} Thus, vicarious liability

\begin{footnotes}
\item[203] Assmann, Microcorporatist Structures, p. 348 (n 197)
\item[204] Assmann, Microcorporatist Structures, p. 349 (n 197)
\item[205] Hofstetter, Parent Responsibility, (n 126)
\end{footnotes}
applies where a hierarchical relationship has been established between the parent and the subsidiary. Consequently, this interpretation, in theory, suggests a sound belief of parent liability for the tort of the subsidiary.207

In a specific case examination, in Autokran208, it was held that where a parent company was permanently and extensively involved in the management of a subsequently bankrupt subsidiary, in this situation a rebuttable presumption exists that the parent did not show adequate consideration for the subsidiary. Hence, unless the parent is able to defend itself successfully, it is directly liable to creditors for the subsidiary’s obligations.209 Similarly, in ITT210 the German Federal Court decided that the parent corporation’s control of a close corporation by its majority influence had a fiduciary duty to the close corporation.211 It is now generally thought that it follows from the relevant cases that such an undertaking holding shares in a dependent company has an enhanced duty of good faith in all its relationships with the company and its shareholders. The parent is forbidden from exercising any detrimental influence on that company, unless all its shareholders agree thereto.212

The former decisions of the Supreme Court concerning such groups had placed emphasis on the controlling undertaking’s lasting and comprehensive involvement in the management of the dependent company, and had made use of definite controversial presumptions in order to impose liability on the controlling company. However, the decision in Video213 caused a great deal of arguments in legal profession.214 In a series of

207 Assmann, Microcorporatist Structures, (n 197)
208 BGHZ 95, 330
209 Hofstetter, Parent Responsibility, (n 126) and Marlow Jennifer ‘Germany: Company Law: Lifting the Corporate Veil’ (1993) 4 I.C.C.L.R. 133
210 BGHZ 1976 JZ 561
213 115 BGHZ 187 (1991)
214 Marlow, Germany, (n 209)
cases leading to the Video case, which included Autokran, and Tiefbau\(^\text{215}\) the court determined when the sole or majority shareholder of a private limited company was to be directly liable if the company failed to fulfil its own obligations and liabilities.\(^\text{216}\)

In Video\(^\text{217}\) the Supreme Court held that a defendant who participated in a private limited company, which were video undertakings, and also carried on a business of his own, was to be regarded as an undertaking.\(^\text{218}\) The court went further than previous decisions holding an individual, even though not a corporate enterprise could be held personally liable for the losses of the subsidiary if he is both the sole managing director and majority shareholder of the subsidiary and he engages in business activities outside the subsidiary as sole owner.\(^\text{219}\) The court with this approach held that the controlling shareholder conducting his own business must be responsible for the losses of the controlled company if he could not otherwise prove that such losses had not arisen from actions he had taken for the benefit of his own business. The importance of the Video cases lies under this; in making this judgment, the court had successfully transferred the traditional burden of proof away from the plaintiff to the defendant-controlling shareholder.\(^\text{220}\)

In the TBB\(^\text{221}\) decision, in 1993, the Supreme Court elucidating its earlier judgment held that the shareholder should not be liable simply because it could not invalidate the presumption of control, but rather the plaintiff creditor must establish justifications and prove that the shareholder's act had actually damaged the business of the dependent company. Where the plaintiff is not in a position to know certain matters, the shareholder must make the information available, provided that he is in a position to know such information and the release of such information is reasonable. With this

\(^{215}\) GBHZ 107, 7
\(^{216}\) Marlow. Germany, (n 209)
\(^{217}\) BGHZ 115, 187; Die AG, 1991, 429
\(^{218}\) Wooldridge, The Situation of Dependent, (n 212)
\(^{219}\) Marlow, Germany, (n 209)
\(^{220}\) Marlow, Germany, (n 209)
\(^{221}\) Zeitschrift fur Wirtschaftsrecht (1993) 589
decision, the Supreme Court in effect transferred the burden of proof back to the other side, so that the creditor must first prove that the dependant company has suffered to its detriment rather than this being an automatic presumption, which must be rebutted by the shareholder. 222

As a result, whereas the previous decisions based the imposition of the liability on the controlling enterprise on the presumption of detriment to the dependent enterprise where there was comprehensive and lasting control over its affairs, the Supreme Court in TBB took a totally different view. The Supreme Court held that the basis of liability in the previous cases was not lasting and comprehensive control over the dependent company but a prejudice caused to its interests. Such prejudice could not, in the opinion of the court, be said to occur on a basis of presumption resulting from such a control. Its existence had to be based on additional factors. 223 However because of the difficulties in articulating detrimental transactions and measures, the Supreme Court considered that a lesser burden of particularising and giving evidence of facts should be imposed on a creditor of a subsidiary who lacked insight into the affairs of the group. It was the defendant who according to the Court’s opinion should bear the burden of giving fuller evidence for facts. 224

In any event, the qualified de facto group concept constitutes, at least in theory, a significant step towards a realistic approach to the issue of the imposition of liability on the controlling enterprise. In spite of the absence of integration and of control contract, liability may be imposed on a parent company merely upon evidence of a continuous and extensive interference with the subsidiary’s management (according to the previous approach) or upon some evidence of prejudice of the subsidiary’s interest (according to approach taken in TBB). 225 However, changing the burden of proof in its latest decisions German Supreme Court (TBB case) made it very difficult to establish

222 Marlow, Germany, (n 209)
223 Avgitidis, Group of Companies, p. 244 (n 96)
224 Avgitidis, Group of Companies, p. 244 (n 96)
225 Avgitidis, Group of Companies, p. 246 (n 96)
liability over parent corporation for its excessive control on subsidiary company. In a highly complex and integrated modern corporate groups with horizontal structure it can become almost impossible for outsiders to trace and prove past violations of the subsidiary’s interests by the parent, shifting the burden of proof to the parent company in a way similar to previous doctrine might, thus, be the only way to rebalance the situation.\textsuperscript{226} Therefore, the decision of \textit{TBB} has had a negative effect on development process of the group liability in Germany.

Although almost \textbf{being 4 decades old}, it is still claimed that German Law on corporate groups is the most advanced in the world and seen as an alternative to the traditional piercing the corporate veil law in the corporate group context.\textsuperscript{227} It has, more importantly, encouraged the evolution of an advanced German judge-made law outside the scope of the Stock Corporation Act.\textsuperscript{228} Thus, the qualified concern doctrine of the German Federal Court seems, at least in principle, well differentiated and promising.\textsuperscript{229}

However, it should not be misperceived that according to the German company law principles, public and private limited liability companies are independent legal entities. The shareholders (including company shareholders) have no personal liability for the commitments of the company. The shareholders of the company can be held personally liable if they have violated their fiduciary duties,\textsuperscript{230} because the original legislator of the Stock Corporations Act of 1965 did not want to implement a strict and direct liability of the parent company. This explains why instead of direct liability of the parent company in respect to the subsidiary’s creditors, the legislator provided a flexible compensation obligation of the parent company in these particular cases.
As a result, the courts have until now only treated the problems of material under-capitalisation in connection with the abuse of position. Therefore, it is neither required by law nor necessary in itself to interpret the shareholders' liability against the will of the legislators.\textsuperscript{231} The legal consequences of the qualified factual group are supposed to be similar to the contractual group of companies: in this case the parent company is likewise obliged to cover the annual losses. Here, again, there is no direct liability of the parent company for the debts of its subsidiaries but an indirect liability for its losses.\textsuperscript{232} Therefore, under German law, the liability of parent company for the debts of its subsidiaries clearly remains an exception. Even for wholly owned subsidiaries such a liability normally does not exist; instead indirect forms of protection of the interests of the subsidiary and its creditors have been introduced.

There has also been a considerable amount of controversy about the exact nature of the liability in the qualified de facto group. Lutter argues that this is based upon conduct, namely the breach of the rules governing the proper management of a group.\textsuperscript{233} Hommelhoff\textsuperscript{234} challenges that it is based upon results, i.e. the use of management powers in the dependent company such that its interests are subordinated to those of the controlling undertaking.\textsuperscript{235} It can be claimed in the comparative view that the German qualified de facto group liability is a German interpretation of veil piercing law since it finds the basics in existence of the close and extensive control exercised by the parent over its subsidiaries. Whenever liability is imposed on the parent, this is done mainly on the ground of the parent's managerial control over the subsidiary. Thus, the issue dealt with in German Stock Corporation Act is not the problem of liability but it is problem of compensation.

\textsuperscript{231} Stender. Company Law... Germany. (n 230)
\textsuperscript{232} Lutter M. 'The Liability Of The Parent Company For The Debts Of Its Subsidiaries Under German Law (1985) JBL 499
\textsuperscript{233} Lutter. The Liability Of The Parent. (n 232)
\textsuperscript{234} Hommelhoff P. 'Protection Of Minority Shareholders, Investors And Creditors In Corporate Groups: The Strengths And Weakness Of German Corporate Group Law' (2001) 2 E.B.O.L.R 61
\textsuperscript{235} Wooldridge. The Situation of Dependent. (n 212)
Therefore, notwithstanding the difference in approach, there are many similarities in language and result between the special German laws governing groups of companies and the rules for such groups under the piercing the corporate veil doctrine. In the German law of company groups, the typical problems of unlimited liability are solved by ‘piercing the corporate veil in an orderly manner’. Granting creditors a guarantee as to the liability of the parent company for all liabilities incur before the termination of control or that of a profits transfer agreement. In de facto concerns or qualified de facto concerns and after the case of TBB, the corporate groups can always avoid liability by proving their control on the company was not reason for the loss or they have no control in first place.

In case of MNEs, all the subsidiaries have independence and the ability to make important decisions under the common group policy, but German groups of companies’ law just depends on the dependence of the subsidiary to its parent which will be applicable to only small sized companies or better private limited companies rather than huge public limited companies. In a horizontally organised MNEs group, many legally independent companies come under networked management. The German Law does not contain any special provisions governing such groups. In such groups there is no apparent control over any subsidiary but there is a common group policy, cultural control and extensive communication so their source of decision-making cannot be traced, which gives subsidiaries the tools to claim to be independent in many cases. The qualified de facto concern is insufficient from this perspective because it considers only simplified vertically structured corporate groups.

As in qualified de facto group the liability arises because of private limited company’s activities. Moreover, pursuant to German private international law, German

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236 Schiessl, The Liability Of Corporations, (n 211)
237 Haar, Piercing Veil, (n 191)
238 Haar, Piercing Veil, (n 191)
240 Detailed discussion is made at chapter 2.
Stock Corporation Law is applicable if the controlled company is located in Germany, whether or not the controlling company is located abroad, but is not applicable if only the controlling but not the controlled company is located in Germany.241

Groups of Companies in Arbitration

In international arbitration cases, there is a question with which both arbitrators and the courts are frequently confronted as to whether an arbitration agreement signed by a member of a group of companies can be extended to include another company of the same group, which has not signed the agreement.242 The question has been responded to in different ways; in most cases arbitrators applied the doctrine of separate legal personality and limited liability. In a situation where justice requires further liability, they have searched solutions on the basic principles of the existing law, which depends on the veil piercing doctrine, agency arguments or estoppels.

In some cases the arbitration tribunals created a new doctrine called ‘group of companies’ doctrine. The group of companies’ doctrine provides extending the jurisdictional scope of an arbitration clause to the non-signatory parent company or other companies in the group.243 Consequently, the doctrine can in some circumstances exposes one side that have a valid arbitration agreement with one member of a groups of companies to an award against them in favour of other companies in the same group.244

241 Rinze Jens, ‘Konzernrecht: Law on Groups of Companies in Germany’ (1993) 14 Comp. Law. 143
244 Leadley J and Williams L, ‘Peterson Farms: There is No Group Of Companies Doctrine in English Law’ (2004) 7 Int. ALR 111
The basics justifications for the ‘groups of companies’ theory are the single economic unit argument and the development process of the relationship between parties. First, under the doctrine, if a group of companies constitute the same economic reality, one company in the group can bind the other members to an agreement. Second, if the result conformed to the mutual intentions of all the parties and reflected the good usage of international commerce, extension of the award is justifiable on the basis of the parties’ express or implied intention. The group of companies’ doctrine provides that an arbitration agreement signed by one company in a group of companies entitles or obligates affiliated non-signatory companies; if the circumstances surrounding negotiation, execution and termination of the agreement show that the mutual intention of all the parties was to bind the non-signatories.

Arbitrators acting under the International Chamber of Commerce (ICC) demonstrate a strong tendency to recognise that an arbitration agreement signed by a company belonging to a group of companies obligates and entitles the other members of such group if that agreement fulfils certain minimum requirements.\(^{245}\) The tendency is strongest among the supporters of *lex mercatoria*. Following the *Dow Chemical* decision and ICC case numbers 2375\(^{246}\) and 5103\(^{247}\), the tribunal recognised that since group of companies constitute the same economic reality, one company in the group can bind the other members to an agreement if such a result conforms to the mutual intentions of all the parties and reflects the good usage of international commerce.

These rulings of the ICC have found strong support from French jurisprudence so the group of companies’ theory has had its consequences on the rulings of French courts, which seems persuaded to follow the new theory as evidenced by a judgement of the

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\(^{245}\) Sandrock Otto, ‘Arbitration Agreements and Group of Companies’ (1993) 27 International Lawyer 941


\(^{247}\) ICC matter no 5103 1988 Journal du Droit international 1206. See Sandrock, Arbitration Agreements, (n 245)
Dow Chemical v Isover Saint Gobain\textsuperscript{248} under which the group of companies' doctrine originated.\textsuperscript{249} Two Dow Chemical companies entered into contracts with the respondent, a French company, for the distribution of thermal isolation equipment. The agreements contained ICC arbitration clauses and provided that deliveries could be made to the distributor by any Dow company. Two other Dow Chemical companies afterwards faced litigation over one of the products and sought to pass their liability on to the distributor by way of ICC arbitration. The French distributor argued that the tribunal's jurisdiction only allowed it to deliver awards in favour of the two Dow Chemical companies with which it had a direct contract. The tribunal then held that the group of companies represented by Dow Chemicals constituted one and the same economic reality and assumed jurisdiction over the companies that had not been named as parties to the contract.\textsuperscript{250} Therefore, the arbitrators held that the arbitration clause signed by two of the companies was also intended by the parties to be available to other companies in the group, commenting that: \textsuperscript{251}“Irrespective of the distinct juridical identity of each of its members, a group of companies constitutes one and the same economic reality of which the arbitral tribunal should take account when it rules on its own jurisdiction subject to Article 13 (1955 version) or Article 8 (1975 version) of the ICC Rules”.\textsuperscript{252}

Since Dow Chemical, the group of companies' doctrine has been followed in a number of ICC Tribunal decisions, such as ICC Case No.5103 and the \textit{KIS France SA v SA Société Générale}\textsuperscript{253} decision of French Appeal Court settled the application of the


\textsuperscript{249} For more cases see Sandrock, Arbitration Agreements, (n 245)

\textsuperscript{250} Woolhouse SP, ‘Group Of Companies Doctrine And English Arbitration Law’ (2004) 20 \textit{International Arbitration} 435

\textsuperscript{251} Born, \textit{International Commercial} p. 656 (n 248)

\textsuperscript{252} An American arbitral tribunal reached a similar result, referring to US national court decisions and observing that it is neither rational nor practical to exclude (from arbitral jurisdiction) the claims of companies who have an interest in the venture and who are members of the same corporate family. Partial final award no 1510, VII Y.B. Comm.Arb.151 (Society of Maritime Arbitrators 28 November 1980) cited at Born, \textit{International Commercial} p. 656 (n 248)

theory in France and others followed the same route. The French courts have generally proved to be in favour of extending the arbitration clause to groups of companies where that extension is justifiable on the basis of the parties' express or implied intention. KIS France had entered into a basic agreement with Société Générale for the sale of miniature photographic laboratories in certain countries. The basic agreement was signed by both parties on their own behalf and on behalf of their subsidiaries. Pursuant to that contract, the subsidiaries themselves dealt with the contractor and its subsidiaries in specific contracts referring to the framework contract. The basic agreement contained an ICC arbitration clause, which was referred in the contracts that subsidiaries signed. A dispute arose concerning unpaid lease fees, and Société Générale and two of its subsidiaries commenced arbitral proceeding against two of the subsidiaries in the KIS group. The arbitrators made an interim award ruling that the claims against the KIS subsidiaries were admissible. The arbitral tribunal held that the co-contractors and their subsidiaries could commence arbitration proceedings based on the framework contract against both the parent company and its subsidiaries. On a challenge by KIS France, the Appeal Court held that 'the notion of group of companies' is recognised under French law and, therefore, the arbitrators did not violate the parties' choice of French law by taking it into account.

A similar approach to KIS adopted by the tribunal subsequently rejected by the English courts in Caparo Group Ltd v Fagor Arrastate Sociedad Cooperative, even though the principles of 'group of companies' doctrine were assured to be specific to the facts of that case. The Spanish company, Fagor and an Indian company known as CML had entered into a signed contract for the sale and purchase of printing presses. In a dispute over non-payment, Fagor sought to hold Caparo, which was a 60 per cent shareholder in CML, liable for the alleged default. Clarke J. held that: "Under English

254 Leadley and Williams, Peterson Farms. (n 244)
255 Gaillard and Savage J, Fouchard Gaillard Goldman. (n 242)
256 Gaillard and Savage J, Fouchard Gaillard Goldman. (n 242)
257 Leadley and Williams, Peterson Farms. (n 244)
258 Commercial Court, Queen's Bench Division. August 7, 1998. Lexis

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law. I can see no basis upon which it could be held that the parties to either the contract or the arbitration agreement were other than Fagor on the one hand and CML on the other. In my judgment, there is no room for a conclusion that Caparo was a party to either the contract or the arbitration agreement."

The position was clarified when Langley J. in the Commercial Court in London, granted the application of Peterson Farms, Inc. an Arkansas company, to set aside parts of an award which had been issued to C&M Farming Limited, an Indian company, in reliance on the group of companies’ doctrine. Langley J. held that these parts of the award were made without jurisdiction. Under a sales right agreement, Peterson had sold male ‘grandparent’ chickens to C&M, which mated them to obtain parents, which could be sold on to third parties, including other entities in the same group as C&M. These third parties then mated the parent birds to produce chicks or hatching eggs to produce broilers for the consumer market. The birds supplied by Peterson were found to carry a virus, which reduced the birds’ capacity to produce healthy chicks.

The sales right agreement was subject to Arkansas law and contained a provision for disputes to be resolved by ICC arbitration in London. A dispute arose as to whether the ICC Tribunal had power to award damages in respect of losses suffered by other entities in the same group as C&M. The tribunal held, based on the doctrine of separability of the arbitration agreement, that unlike the main body of the sales right agreement, the arbitration provision was not subject to Arkansas law. The tribunal held that the scope of the arbitration agreement is determined autonomously, in accordance with principles of international law and arbitral practice rather than application of national law. Thus, the tribunal took the view that this entitled it to apply the ICC precedent, including the group of companies’ doctrine.

Based on current correspondence, the tribunal in Peterson formed the view that Peterson had intended throughout to deal with the C&M group as a whole and had

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contracted with one member of the group purely as a matter of convenience, the group not being a legal entity. Accordingly, C&M obtained an award of some US$6.7 million, of which some US$5.5 million related to losses suffered by other C&M group entities, which were not named as parties to the Sales Right Agreement. Moreover, some of them, at the time the sales right agreement was entered into, were partnerships rather than companies.

Peterson brought a challenge in the Commercial Court in London under s.67 of the Arbitration Act 1996, arguing that the tribunal had no jurisdiction to award damages to entities which were not parties to the arbitration agreement. Langley J. found that the arbitration provision was subject to the same express choice of law clause as the rest of the sales right agreement. Therefore, the tribunal's decision was 'seriously flawed' and there was no basis for the tribunal to apply any law other than that chosen by the parties, i.e. Arkansas law. It was agreed between the parties for the purposes of the s.67 challenge that Arkansas law was the same as English law in consideration of the 'group of companies' doctrine, and Langley J. ruled that "English law treats the issue as one subject to the chosen proper law of the Agreement and that excludes the doctrine which forms no part of English law". Accordingly, the view of the English court is that an ICC arbitral tribunal has no jurisdiction to apply the 'group of companies' doctrine. However, the decision might have been different had Arkansas law recognised the group of companies doctrine.260 Under US law, the ultimate question of whether a party has agreed to arbitrate a dispute is to be decided by the federal courts, not by the arbitral tribunal.261 Thus, the basis for binding non-signatories to arbitration agreements under a theory of implied consent derives from the US common law principles pertaining to related parties veil piercing, alter ago, agency, assumption and estoppels and related agreements.262

260 Woolhouse, Group Of Companies (n 250)
261 Lamm and Aqua, Defining the Party. (n 243)
262 Lamm and Aqua, Defining the Party. (n 247) and Hanotiau, Problems Raised by Complex. (n 246)
In consideration of the French Appeal Court’s approach in the KIS case, it seems that Peterson might have been differently decided under French law. The KIS case differed from the Peterson case in that KIS was challenging an award against respondents who were not directly parties to the arbitration agreement, whereas Peterson was challenging an award in favour of claimants who were not parties. However, the judgment of the French Court is expressed in very general terms, and it appears to provide no immediately obvious reason why the French Court would not apply the ‘group of companies’ doctrine in a case that was closer to the facts of the English decision.

Commentators differ as to whether the ‘group of companies’ doctrine in arbitration practice is distinct from the existing principles allowing the corporate veil to be pierced. Gaillard and Savage, for instance, consider both together, whereas Born and Hanotiau distinguish the group of companies’ doctrine from alter ego claims in which a company or individual is deliberately contracting in such a way as to evade legitimate responsibilities. The alter ego doctrine characteristically requires an element of fraud to be established but the groups of companies’ doctrine can be applied without fraud.

It has been claimed that if a tribunal is justified in allowing entities that were not party to an arbitration agreement to become parties to the arbitration, there are alternative instruments that could be used. For instance, it may be possible to argue in appropriate cases that the respondent is estopped by its conduct from denying that the additional entities were parties to the arbitration agreement, or that there has been fraud, which justifies piercing the corporate veil. Consequently, a general ‘group of companies’ doctrine is unnecessary. The rule created by lex mercatoria has little legal certainty and its definite forms are vague and open to discussion. Indeed, in the French case of

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263 Gaillard and Savage J. Fouchard Gaillard Goldman. (n 242)
264 Born, International Commercial p. 653-700 (n 248) and Hanotiau, Problems Raised by Complex. (n 246)
265 Leadley and Williams, Peterson Farms. (n 244) and Sandrock, Arbitration Agreements. (n 245)
266 Sandrock, Arbitration Agreements. (n 245)
The examination of the cases indicates that the ‘group of companies’ doctrine originates from the similar principles that the veil piercing doctrine originated. The doctrine was created because justice required it. Thus, most of the commentators as well as English courts see the doctrine as unnecessary since there is already a valid doctrine that provides enough protection under the principles of alter ego or fraud or some principles of estoppels. Moreover, it is not so much the existence of a group that results in the various companies of the group being bound by the agreement signed by only one of them, but the true intention of the parties was considered important. Thus, the ‘group of companies’ doctrine originated from the assumption that the involvement of other companies in the group in the negotiation or performance of the contract implicitly proves their agreement to be bound by the clause. Thus, the theory has been shadowed most of the time by the phrase of ‘intended by the parties’. Indeed, in the French cases the legitimacy for the application of the theory is established under the principles of justice. The term single economic unit was attached the extra requirements that the parties to behaviour must have supported the application of the theory. Thus, evidence of the managerial facts in each particular case is important. It makes the result of the cases unpredictable and more importantly successful awards will be only rare.

The argument carried out in this thesis, is that the group of companies must be liable in a way that reflects their ownership and managerial structure in a modern organisational structure. The group of companies’ doctrine in arbitration cases has indicated some important points with reference to the single economic enterprise theory. However, requiring extra facts for each case reduces its reliability. Moreover, under the horizontal structure of MNEs, the link between companies is not apparently seen in

Orri v Société des Lubrifiants Elf Aquitaine the Paris Appeal Court relied on both principles, although the Cour de Cassation subsequently upheld the decision based on the alter ego ground, while not considering the ‘group of companies’ argument on the facts.

268 Gaillard and Savage J, Fouhard Gaillard Goldman, (n 242)
every particular case. Modern organisations have complex networked structures and it is almost impossible to trace every transaction or operation. Thus, if one searches for extra facts to prove real intention, he will fail to prove clear veil links between member companies under the group. Thus, the group liability introduced by arbitrators has some shortages to be considered as efficient models of imposing liability on corporate groups and it can be claimed that **groups of companies doctrine in arbitration is just innovative just between the borders of limited liability.**

Moreover, the ‘group of companies’ doctrine can be applied just only in commercial matters since arbitral litigation needs the consent of the parties in advance. But this new perspective is important for the thesis in theory since arbitration agreements require mutual agreements of both sides to solve the dispute in arbitration tribunals and can only be drafted in advance before the conflict. In terms of tort claims it seems very unlikely to take the conflicts to the arbitral hearing.

Finally, although the case law of common law countries denies the ‘group of companies’ doctrine, the eagerness of arbitrators to create the ‘group of companies’ doctrine seem to be enduring. Legal consultants to MNEs will be forced next time to sign agreements that are binding all the companies under the group since the arbitral organisations are more aware of the current economical and organisational structure of the MNEs. Therefore, the international law creating role of international arbitration organisations may bring to MNEs liability a new perspective.

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269 Detailed discussion is made at chapter 2.
The Comprehensive Environmental Responsibility and Compensation Act (CERCLA)\textsuperscript{270}

In 1980, the United States Congress enacted the CERCLA to ensure that every party that was potentially responsible for environmental torts would be held responsible for the resulting harm. There are four classes of potentially responsible parties for environmental torts under CERCLA section 107: 1- the current owners and operators of a facility; 2- persons who formerly owned or operated the facility at the time of disposal or treatment of hazardous substance; 3- persons who arranged for the disposal or treatment of hazardous substance; and 4- transporters of hazardous waste.\textsuperscript{271} Accordingly, CERCLA liability may attach to a corporate owner in two ways: (i) direct liability under the operator language of CERCLA's section 107(a), and (ii) indirect liability as owner through common law veil piercing.\textsuperscript{272}

For the purpose of the study, the liability of owner or operator's liability is examined here. The owner or operator of a facility is defined as any person owning or operating such facility, excluding a person who, without participating in the management of a facility, holds indicia of ownership primarily to protect his security interest in the facility. Thus, CERCLA failed to express any apparent intention to hold parent corporations or other shareholders individually liable for corporate activities because CERCLA's definitions of person, owner or operators include corporations and other business entities as well as individuals, but no specific reference is made to parent corporations or shareholder liability. Hence, there is a dispute about whether owners or operators can be interpreted to include parent companies.

CERCLA's present definition of operator liability has left the courts with no inspiration. In their pursuit for balancing the contradictory liability principles, court

\textsuperscript{270} Another US statute, ATCA, is discussed in the chapter 3.

\textsuperscript{271} Bakst. Piercing the Corporate Veil. (n 53)
approached this issue by adopting one of three basic approaches; 1- the most extensive imposition of liability under the ‘authority to control’ or ‘capacity to control’ principles; 2- the ‘actual control’ test and 3- derivative-only liability, which declines to hold parent corporations directly liable as operators under any conditions, other than when circumstances are adequate to pierce the corporate veil.273

First, in *State of Idaho v. Bunker Hill Co*274, a federal district court developed the *capacity to control* standard, the broadest reaching theory of parent corporation liability under CERCLA. In the case the court concluded that the parent and its subsidiary were ‘so intertwined’ and that the parent ‘so controlled the management and operations’ of the subsidiary that the parent constituted an ‘owner or operator’ for purposes of CERCLA. Parent corporations are supposed to be liable because the CERCLA language points to them as owner and operator. The *Bunker Hill* court relied on *United States v. Northeastern Pharmaceutical & Chemical Co.*275 The court adopted the view that the remedial goal of CERCLA required a more expansive view of liability. Therefore, parents have the capacity, if not the totally reserved authority, to make decisions and implement actions and mechanisms to prevent the damage.276 However, despite the numerous federal district courts recognising the capacity to control test as the requisite level of involvement, no federal appellate court has recognised this test in the context of parent-subsidiary liability.277 They affirm their argument in the belief that this approach seemed to be fully in contradiction to the traditional common law concept of limited liability for owners of corporation, because parents could be liable for simply owning a

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273 Alexander and Sawez, Toward a Uniform, (n 272) and Hofstetter, The Ecological Liability, (n 77) and Stone, Parent Corporate Liability (n 206) and Silecchia Lucia Ann, ‘Pinning the Blame & Piercing the Veil in the Mists of Metaphor: The Supreme Court's New Standards for the CERCLA Liability of Parent Companies and a Proposal for Legislative Reform’ (1998-1999) 67 Fordham L. Rev. 115
275 579 F. Supp. 823
276 Hofstetter, The Ecological Liability, (n 77) and Farmer, Parent Corporation, (n 42)
277 Alexander and Sawez, Toward a Uniform, (n 272) and Farmer, Parent Corporation, (n 42)
subsidiary, and not for any actions directly taken by the parent with regard to the contamination.278

The second approach, **actual control**, was created by the District Court of Rhode Island in *United States v. Kayser-Roth Corp.*279 The court stated that a parent corporation cannot, as a rule, be believed to be an operator solely on the basis of its status as a shareholder.280 The court considered the appropriate standard to apply and determined that the *Bunker Hill* court's capacity to control test was too broad. Accordingly, the court's ruling was two-sided: it first relied on the basic principle that under federal law, a corporate entity may be disregarded in the interest of public convenience, fairness and equity. Secondly, direct liability holds the corporate parent liable if it acted as an operator of the site and the parent corporation must have had **persistent control** over the management of its subsidiary in order to incur direct liability. *Kayser-Roth* was found to merit such liability. Under the case, liability was not imposed on the parent corporation because of its capacity to control but the courts searched for persistent control over the subsidiary.281

Thirdly, the Fifth Circuit adopted the traditional **alter ego** (veil piercing) liability principle for determining the liability of a parent corporation under CERCLA in *Joslyn Manufacturing Co. v. T.L. James & Co.*282 The Fifth Circuit refused to apply the expansive reading to CERCLA's liability provisions. The CERCLA does not define 'owners' or 'operators' as including the parent company. The court found that the lack of explicit statutory language addressing the issue of parent corporate liability meant that federal courts lacked the authority to impose liability without piercing the corporate

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279 910 F. 2d. 24 (1st Cir. 1990) other cases; Jacksonville Electric Authority v. Bernuth Corp. 996 F.2d 1107, Lansford-Coaldale Joint Water Authority v. Tonolli Corp. 996 F.2d. 1107 (11th Cir. 1993)
280 Hofstetter, The Ecological Liability. (n 77)
281 Farmer, Parent Corporation. (n 42)
282 893 F. 2d. 80 (5th cir. 90). Also see United States v. Cordova Chemical Co. 113 F.3d 572 (8th Cir. 1997)
veil. Nor does the legislative history indicate that Congress intended to alter a basic principle of corporation law so significantly. The Joslyn court maintained that Congress is quite capable of creating statutes that hold shareholders or controlling entities liable for the acts of corporations. However, in Joslyn the court was asked to rewrite the language of the Act significantly and hold parents directly liable for their subsidiaries' activities. To do so would dramatically modify traditional concepts of corporation law. The court then returned to the traditional, common law corporate veil piercing test, and agreed with the district court's findings that the parent's relationship with its subsidiary did not permit imposing liability on the parent. The subsidiary authentically adhered to basic corporate formalities by keeping its own books and records and holding frequent shareholder and directors meetings. The daily operations of the subsidiary and the parent were separate. The Supreme Court approved a review of Joslyn Manufacturing in United States v. Cordova Chemical Co that rejected all theories for parent corporation liability except for indirect owner liability under state veil piercing law.

After these complicated court rulings there was a need for a definitive Supreme Court statement on parent corporation liability under CERCLA. United States v. Bestfoods provided that statement. This decision reinterpreted the Circuits' stiff reading of parental liability and held that while a parent could still be liable under the restrictive veil piercing theory employed by the Sixth Circuit, a parent could now also be liable under a direct operator standard if it acted as the operator of a facility owned or operated by its subsidiary. This also diverged from lower court rulings that had previously considered direct liability by looking at the parent's legal relationship to the subsidiary rather than to the facility.

285 Michigan, 113 F.3d 572, 580 (CA6. 1997)).
286 524 US 51 (1998)
287 Rolle, United States v. Bestfoods (n 284)
288 Silecchia, Pinning the Blame. (n 273)
The key question in *Bestfoods* was whether a sole investor, a parent corporation that exercised control over a subsidiary, was safe from liability for damage involving the cleanup of industrial waste when the damage was done by its non-operational subsidiary. The specific issue before the Court was whether a parent corporation that actively participated in, and exercised control over, the operations of a subsidiary may, without more, be held liable as an operator of a polluting facility owned or operated by the subsidiary. The court said no; instead concluding that a corporate parent that actively participated in and exercised control over the operations of the facility itself may be held directly liable in its own right as an operator of the facility. The Supreme Court rejected the position that the parent is directly liable as an operator because it actively participated in and exerted significant control over the subsidiary's business and decision-making. The court said first that it is a general principle of corporate law deeply embedded in our economic and legal systems that a parent corporation is not liable for the acts of its subsidiary; second, that the corporate veil may be pierced and the shareholders held liable for the corporation's conduct when the corporate form would otherwise be misused to accomplish certain wrongful purposes, most notably fraud, on the shareholder's behalf. The court's new, middle ground of liability required a parent corporation to actively participate in and exercise control over the subsidiary's business during a period of disposal of hazardous waste. Instead, according to the court, the question addressed by the district court should have been about the parent's interaction with the facility of the subsidiary. The question is not whether the parent operates the subsidiary, but rather whether it operates the facility, and that operation is evidenced by participation in the activities of the facility, not the subsidiary. As a result, the key to direct liability, according to the Court, is that the parent must exercise actual control.

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290 Gelb, CERCLA, (n 289)
291 Gelb, CERCLA, (n 289)
293 Gelb, CERCLA, (n 289)
over the facility (without regard for the parent’s control of subsidiary). If any such act of operating a corporate subsidiary’s facility is done on behalf of a parent corporation, the existence of the parent-subsidiary relationship under the state corporate law is simply irrelevant to the issue of direct liability. Thus, parent corporations can avoid liability by either not participating in the subsidiary’s hazardous waste operations, or doing so with cautious oversight. If their interaction with their subsidiaries is not unusual, there is no need to find them liable as owners.

The Bestfoods decision abolished the capacity to control test and narrowed the actual participation and control test. The decision also preserved indirect liability as a separate means of imposing liability. However, while Bestfoods did establish that parent corporations could be held directly liable as operators under CERCLA, the determination of which factual scenarios will justify such liability appears to have been left for the lower courts to decide.

As these cases demonstrate, the liability of a parent corporation has stayed untouched despite the consequences of whether liability is based on traditional corporate law or direct statutory liability under the CERCLA. Liability does not occur merely by virtue of their ownership of stock, but rather by direct control over the subsidiary or the facility and for the wrongdoings. In cases in which parent corporations might be held liable under CERCLA, the parents must be in a situation of exercising control over the activities leading to the CERCLA violations. The courts simply hold parties liable that might be held liable under traditional corporate law doctrine. Analysis of the case law

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294 De Monte, Impact of United States v. Bestfoods, (n 278)
295 Rolle, United States v. Bestfoods (n 284)
297 Alexander and Sawez, Toward a Uniform, (n 272)
298 Yeo. United States v. Bestfoods, (n 296)
300 Oswald Lynda J and Schipani Cindy A. ‘Cercla And The ‘Erosion’ Of Traditional Corporate Law Doctrine’ (1992), 86 Nw. U. L. Rev. 259
simply does not support a conclusion that the courts are eroding traditional corporate liability rules regarding parent corporations in the CERCLA context.

One of the important reason of failure of the CERCLA as an efficient example of corporate groups liability in tort is its misunderstanding of groups’ structure by considering them as simple vertically structured organizations rather than horizontally structured organizations. In the original text of the Act, there is no mention of parent liability but was owners and controllers’ liability is the source of liability. Accordingly, the courts have to search for owner and controller in subsidiaries’ environmental damage. This leads courts to look for a particular structure under which a parent applies excessive control over its subsidiaries, which is similar to vertical structure discussed earlier. Thus, a regulation just based on characteristics of vertical organizations fails to create an extensive liability regime and thus is inefficient. The same happened in CERCLA cases. Even though liability claims for corporate groups are brought under CERCLA’s provisions, they have failed to offer any better solution than traditional veil piercing doctrine offer.

In conclusion, CERCLA’s provisions are sophisticated, thus, they contain many drafting gaps, which might be claimed that the Congress intended the federal courts to fill through federal common law. The CERCLA may have developed better conditions for piercing the corporate veil since it particularly agrees the issue of operator’s role on the subsidiary. However, it has failed to do so after the courts traditional interpretation of the rules and their failure to adopt modern interpretation of corporate groups’ operational structure.

\[301\] Farmer, Parent Corporation. (n 42)
Turkish Law

According to the articles 503/1 and 269/2 of Turkish Commercial Code, shareholders of the private limited company and public limited company have limited liability. And article 532/1 of Turkish Commercial Code defines the limit of the liability of the shareholders as the capital promised to be paid into the company. Shareholders can save themselves from further liability by paying this amount if the company’s assets are not enough to cover all the debts.

In Turkish law, there are two kinds of companies under which shareholders are unlimitedly liable. In Kollektif Company, every shareholder is unlimitedly liable disregarding the proportion of capital they promised to pay. In Komandit Company, there are two kinds of shareholders: one is unlimitedly liable similar to Kollektif company shareholders and the other is liable just for the capital he promised to pay. However, these two kinds of company structure have no importance in commercial practice. Turkish law has two most common company law forms: limited sirket (private limited company) and anonim sirket (public limited company). Both of them recognise companies as distinct legal personalities and grant limited liability to shareholders of companies. Accordingly, the problems that limited liability companies created have occurred under the Turkish system as well.

When there is a claim for misuse of the company structure, there are not many options for the courts except for the general principles of Turkish Commercial and Civil Codes. In cases of breach of good faith rules, article 2(1) of the Turkish Civil Code states that “every person is bound to exercise his rights and fulfil his obligations according to the principles of good faith”. Accordingly, courts might remove the corporate veil and decide according to the facts of the particular case. In this case judges will look at on which conditions separate corporate personality and limited liability are used in breach of good faith. Article 2(2) of Civil Code states that “the law does not sanction the evident abuse of person’s rights”. This regulation might also be used by the
courts to ignore the corporate veil in cases where the corporate structure has been misused.

Overall, these broad discretion rights have not been used in favour of developing a doctrine similar to piercing the corporate veil. In cases, which are too disorganised to classify, the reasoning to remove the corporate veil was very similar to the common law doctrine of alter ago. In the case of corporate groups, a similar doctrine to the fraud principle has been developed by court to remove the corporate veil. In the cases that shareholders are liable there must be connection between the act of misuse and debts. The claimants have to prove that the debts occurred because of the misuse of corporate form.

However, there is a recent law, The Law Regarding with the Procedure of Collection of the Money Owed to the State, (Amme Alacıklarının Tahsili Usulu Hakkında Kanun, AATUHK) which introduces an exception to limited liability rule. The main exception to the limited liability of the shareholders is situated in article 35 (introduced in 1998) of the Law with the phrase “the shareholders of private limited company are liable in accordance in proportion to their capital shares for the debt owed to the state”. The objective of the law is to prevent misuse of company structures to avoid liabilities.

There are two conditions for the debts: first, it must be owed to the state or local authorities; and, it must have originated from the performance of public services. The most important sources of debts are taxes, duties, fines and other fees. The second condition is that collecting the money from the company must be impossible. Thus, the liability of shareholders is secondary because the shareholders are liable if the company’s funds are not enough to pay the debts.302 Thus, the state will try every possible legal avenue to collect money from the company and if they cannot recover the debts they will go to shareholders in proportion to their shares in the company.

302 Eyibilir Ihsan, ‘Limited Sirket Ortaklarının Sorumluluğu’ (1995) 32 Yak Der 93
According to the decisions of the Turkish Council of State, the last owner of the shares must pay the debts. The liability is founded on becoming shareholders of the company. Thus, taking legal action against the owner of shareholders at the time that the dept has occurred is wrong.\textsuperscript{303} The idea behind this is that if you transfer your shares, you transfer it with the rights and liabilities.

The importance of the law comes from the fact that the law is a very fundamental exception to the company law and limited liability principles. It removes liability barriers for all shareholders by not requiring any other conditions such as alter ago or misuse of corporate forms. Therefore, the application of the law has not brought much confusion in Turkey since it clearly indicated liability on shareholders and more importantly it neither reduced the number of private limited companies nor deterred people from establishing new companies. However, it only removes the corporate veil in private limited companies. Public limited companies still have their limited liability untouched. Consequently it cannot be claimed this law has changed liability structure of corporate groups in terms of Turkish Law.

The most important characteristic of this law is that it has proved that limited liability rules could be abolished for some particular debts of the company. In normal conditions, in any ordinary company, money owed to the state is bigger than debts owed to the involuntary creditors. And the liability to the state will occur for sure since companies have to pay taxes and other fees. If such an important and broad liability can be transferred to shareholders, liability for involuntary creditors can definitely be achievable. This law has also proved that more liability will not destroy the Turkish company structure or Turkish economy. The number of new companies established in Turkey increased fundamentally in recent years even though the application of this law has been settled.\textsuperscript{304}

\textsuperscript{303} Turkish Council of State (Danistay) & D. 2/12 1999E. 1997/847 K. 1999/ 4008
\textsuperscript{304} Hürriyet (Istanbul, 04. September, 2005)
The latest attempt to regulate corporate groups has taken place in Turkey. Since 2001, a commission which consists of scholars and practitioners had been preparing Draft Commercial Law Reform Bill, 2005 which includes company law regulations. The commission conducted very detailed comparative work for company law in order to achieve the aim of the new commercial code, which is to create the most up to date commercial code in Europe. In terms of company law provisions, they have been inspired by European, English, German, French and Swiss laws. Moreover, the Draft Bill has generated many unique proposals some of which are very innovatory in the world of commercial regulations.

In terms of corporate groups, the Draft Bill provides a section, which is not lengthy, consisting of 20 articles and it aims to create a very broad regulatory system for groups of companies. The Bill mentions the German Stock Corporation Act, developments in French Labour Law, Italian Bankruptcy Law, British Take-Over laws, and 7th and 9th EU Company Law Directives as examples of the developments in groups of companies laws in comparative perspective. In explaining the regulation, the Proposal analyses that groups of companies are in the centre of economic activities both at domestic and international level. Thus, the Draft Bill is aiming, by regulating groups of companies, to balance the realities of economic life and the rule of law.

In order to create a new and modern group of companies' regime, the commission adopted some articles from the German Stock Corporation Act 17-21 related to groups of companies. Some proposed articles relating to subsidiary companies have been inspired from articles 291-337 of the German Stock Corporation Act. Moreover, the commission has taken into account the suggestions of Forum Europeaum in creating the organisation of the sections on groups of companies. However, the organisation of the Proposed Bill, especially those related to liability are unique to the Draft Bill.

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306 The commission mentions that German Stock Corporation Law originally is based on concern, but it turned to be qualified de facto concern by the decisions of German Supreme Court.
The Draft Bill uses groups of companies as its main description. The Draft uses the term of control in its description of group of companies rather than domination or applied authority by one company over another. In control, there are certain criteria to determine whether it exists or does not exist, such as holding majority voting rights. In domination criteria, any kinds of established authority over another company will be considered as domination. Therefore, in many regulations, criteria for the existence of control are determined in advance and thus, there is no need to search for domination. For example according to 7th EU Company Law Directive a company cannot omit consolidated accounts by just proving there is no domination of parent. Accordingly, art 195(1) of the Draft consider the control system as its main system, additionally it recognises supposed control theory in article 195 (2).

The Draft includes only limited liability companies, rather than including every enterprise, as does the German stock Corporation Act, which covers not only limited liability companies but also other enterprises recognised by the law. The Commission explains why it is just based on limited liability companies claiming that Turkey is for the first time regulating groups of companies and the Draft regulates it in just 20 articles as part of new commercial law, thus it is very difficult to cover such a comprehensive group system. Other types of enterprises, rather than limited liability companies, are not widely used in Turkish economic life. Moreover, according to draft article 195(6) on top of the group there might be a real person or an unlimited company or any other enterprise.

In the determination of holding companies and their subsidiary companies, if there is a control exercised by one company over another, this section (corporate groups) will be applied to those companies and the controlling company is considered to be a holding company while the controlled company is considered to be a subsidiary. According to draft article 195(1) there is a control if one company directly or indirectly has (A) 1- majority voting rights of another company 2- a right to appoint directors who has majority of votes in another company 3- a rights to use majority voting rights in another company, together with his votes, based on an agreement with other members. (B) If there is a control agreements between two companies. Moreover, in article 195(2),
there is a theoretical (supposed) control if one company holds majority of shares or shares that might have the effect of a majority over another company. The difference between 195(1) and 195 (2) is that in the first paragraph the control is certain and parties cannot argue the opposite. However, under the second paragraph parties can always avoid being subjected to the groups of companies’ regulations by proving there is no exercised control over the subsidiary by the holding company. Moreover, article 195(3) states that there is indirect control if one company controls another company through subsidiary companies or together with them. According to article 197, titled reciprocal ownership, if two companies own at least a quarter of the shares of each other, there is a mutual group. And if one establishes control over the other, the controlled one will be considered subsidiary company. If both control each other, both will be considered a subsidiary company.

The Draft Bill imposes some duties on holding companies. For example, article 198 requires a company to register and publicise when it directly or indirectly owns 10, 20, 25, 33, 50, 67, 100 percent of the shares another company. If a company fails to perform registry and publicity requirements, the punishment will be withholding its voting rights. The Draft Bill (art. 199) also requires holding companies to prepare annual group reports. A holding company has to prepare the report within 3 months of acquisition of the subsidiary showing the scale of the relationship between holding company and subsidiary company. The report has to be well prepared and indicate all the facts. Moreover, the report has to show if there is a loss by the subsidiary company, which occurred as a result of a holding company’s decision, also it has to show if the loss is paid back or planned to be paid back.

From the point of the discussion in this thesis, the draft bill imposes some liabilities for holding company if it performs its controls over the subsidiary unlawfully. The commission claims it is unique regulation since it covers every misuse of control without limiting it to certain types of transaction. The main liability clauses regulated in draft article 202: (a) “unless it is compensated in operating year or it is clearly stated how it will be compensated before the end of operating year, the holding company cannot use its control in a way to put the subsidiary company in a

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disadvantageous situation (b) if the compensation is not performed, every shareholder can demand from the holding company and its directors who have voted in favour of the transaction, reimbursement to the subsidiary company of the amount it lost. (c) Creditors of the subsidiary company may as well demand reimbursement of the loss to the company".307 Article 2002 paragraph (d) regulates a condition under which compensation cannot be claimed. Accordingly, if the decision that caused the disadvantage would have taken by the independent directors acting in good faith, there will be no compensation liability for holding company.

In case of a fully owned subsidiary (art. 203) the directors of the subsidiary have to obey the order of the parent company, which is acting according to pre-determined group policy. This article was inspired from the Rozenblum decision of the French Supreme Court.308 However, article 204 bans holding companies from giving orders that are exceeding the assets of the subsidiary or endangering its capability to make payments. Consequently, the directors of the subsidiary are not liable for the decision they have taken in line with articles 203 and 204. As a result, creditors of the subsidiary company can demand compensation from the holding company and from its directors if they have not performed their compensation duties for disadvantageous acts and it has caused damage to the creditors of the subsidiary (art. 206).

If a holding company establishes a perception of group image that assures the public and consumers, there will be liability arising from group credibility (art. 209) for losses arising from usage of this image by a subsidiary. The proposal is the first attempt to regulate liability arising from the image of the group, which was firstly created in Switzerland by the Federal Court’s decision of Wibru v Swissair.309

As result, the Draft Bill could be considered innovative from some perspectives. First of all it brings positive developments by producing a unified proposal including

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307 The author’s translation

308 The doctrine is examined previously in this chapter. (p 217) See Tekil Muge. (in Turkish)’Rozenblum Karari ve Grup Cikari Karari’ (2006) 10 HPD 213

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almost every positive development in Europe. The Bill finds its main structure in defining group of companies in the German Stock Corporation Act and it creates its system inspired by the suggestions from Forum Europeaum. Moreover, it does not refrain from getting some ideas and rules from different jurisdictions such as French Rozenblum doctrine or Swiss Federal Courts decision in Wibru v Swissair case.

The liability clauses are much broader. First of all it creates a supposed control theory, which was referred to by the German Supreme Court’s decisions as well as by CERCLA litigation in the USA and European Competition Law litigations. Moreover, the enforced liability upon holding companies for any unlawful control over subsidiary companies that cause disadvantageous economic situations is impressive. Especially, imposing liability on groups of companies for a misleading use of a group image is interesting and could create a model for future regulatory efforts for groups of companies.

However, there are many weakness of the Draft Bill in terms of creating better liability rules for groups of companies and thus for MNEs. First of all, neither the Draft Turkish Commercial Code nor sections related to groups of companies aim to abandon limited liability company principles in corporate groups. Accordingly, companies established under Turkish law have limited liability protection for their shareholders and there is no difference between individual shareholders and company shareholders. The liability clauses in the context of groups of companies in the Draft Bill require additional conditions for liability to be established. Thus, on those conditions, the draft regulations must be examined from two perspectives: whether they are successful in creditor protection and whether new understandings of group of companies mirror the modern conception of corporate groups and MNEs.

The liability imposed on the holding company does not necessarily guarantee a payment to subsidiary’s unfulfilled creditors. First of all, groups of companies exist only in certain conditions and the supposed control of the parent over a subsidiary is always

306 Switzerland Federal Court (BGE 120 II 331) Akkanat H and Aydinçık S ‘Grup Sirketleri Baglaminda
rebuttable. Although the parent owns the majority of shares it can escape from liability just proving it did not perform control over subsidiary. Moreover, there is no liability occurring if the holding companies’ control over the subsidiary is not considered unlawful. In this case, on many occasions, especially those related to involuntarily creditors, even though a subsidiary committed a tort and it caused mass disruptions, holding company might escape liability just proving it did not perform unlawful control over subsidiary corporation. Thus, the new regulations will provide better protection for voluntarily creditors than it provides for involuntarily creditors.

The second argument must be whether the Draft Bill has a perception of modern group of companies and MNEs or whether it falls into the same mistake that perceives group of companies as a vertical organisation under which divisions between the units of the group are easily distinguished. It can be claimed that the Draft Bill is based on the idea of vertical integrated groups of companies and comparatively smaller domestic enterprises. It aims to make parent companies liable for the debt of the groups thus there is a requirement of control of the parent over subsidiaries. The whole section of the regulation is dedicated to determine which company is a parent and which company is a subsidiary. The difference between parent and subsidiaries is determined according to control theory. Accordingly, liability is imposed if parent applies direct control over subsidiaries. Some provisions could be considered, from some aspects, closer to the modern structure of corporate groups, such as mutual ownership or indirect ownership but even these provisions might make its efficiency insignificant under the general liability system created according to the narrow perception of a simple vertical structure. Accordingly, the liability proposed in the Draft Bill is parent companies liability for its control over its subsidiaries. The difference from the earlier rules and principles discussed above is the comparative reduction of conditions for proving control over subsidiaries. Thus, the Draft Bill will not solve the liability problems since the horizontally organised groups can still avoid liability because of the difficulties of proving of unlawful control applied to subsidiaries.

Culpa in Contrahendo Sorumluluğu (2006) 10 HDP 219
Overall, the Draft Bill is a brave effort since it aims to create the most developed liability regime for group of companies but it cannot be considered innovative enough to solve the tort liability problems of MNEs.

**Evaluation of the Chapter**

This chapter aims to discuss the existing laws and regulations that impose some forms of liability for corporate groups from different jurisdictions. It has been discovered that there is no uniform comprehensive modern law or principles that can provide solutions to the liability problems of MNEs because the existent regulations have produced no real challenge to core areas of company law. Indeed, even the most compact corporate group law, the German Stock Corporation Act, seeks to preserve the subsidiary as a separate entity in that the parent owes duties of compensation to the creditors of the subsidiary in return for the power of control. In that way German law remains grounded in the logic of the classical theory of corporations. The regulations are insufficient to offer a new, broad and internationally effective system by establishing new theories based on modern social, economic and managerial characteristics of corporate groups and MNEs. Instead some efforts have been made to find exceptional solution for the problems under different institutions of law.

The English legislative efforts, in first instance, considered possible economic effects of new regulations on capital markets. In the process towards producing a proposal for a new company law statute, issues related to creditor protection and corporate groups have been removed basically for economic reasons. The main regulatory efforts related to corporate groups, thus concentrated mostly on accountancy and tax issues. On the other hand, creditor protections have been the subject of regulation in Insolvency Law under fraudulent and wrongful trading principles.

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310 Prentice, *Some Aspects of the Law*, (n 22)
However, none of these has challenged the current situation in corporate group law. Neither does the Companies Act 2006 offer any solution: even worse it does not accept the existence of any problems regarding involuntarily creditors.

The efforts that have been carried on at the EU level have as well been undermined by the fear of economic inefficiency. Moreover, different approaches to the problems in the member states weakened any chance of possible changes in the EU law. Thus neither of the European conceptions creates inclusive proposals that can be a solution to contemporary liability discussions. Instead they try to walk on a tightrope between the apparent benefits of limited liability and the evident necessity of putting groups of companies under modified liability designs for their tort actions. Some of the proposals (at least in theory) have created better hope and understandings in the area. However, they are still based on existing principles of liability by either requiring the proof of some violation of duties to the subsidiary or by giving the parent company a chance to avoid liability by proving non-existence of excessive control over subsidiaries. Even such influential approaches as the former articles of the draft European Company Statute would not deliver unconditional liability for the corporate shareholders in corporate groups. Thus, there is no group liability for subsidiaries' tort in any situation.\textsuperscript{311}

The comparative examination of the laws from different jurisdictions highlights many points of weakness in the area of corporate groups' law since each of these regulations aims to cure a very particular problem of limited liability for corporate groups. For example, CERCLA tries to establish broader liability for environmental hazards. Turkish AATUHK aims to prevent misuse of private limited company forms for debts owed to the state. However, this plurality of the regulations creates diverse group concepts and various and even conflicting legal policy perceptions towards groups of companies.\textsuperscript{312}

\textsuperscript{311} Hofstetter, Parent Responsibility, (n 126)

\textsuperscript{312} Irujo, Trends and Realities, (n 7)
This lack of statutory intervention in the problem of groups of companies increases expectations from the courts to fill the gap but they are reluctant to admit the reality of interrelated companies in a complex structure acting as a number of companies affecting each other while at the same time holding each other's shares. This situation leads to the claim that even the statutory laws have offered more developed solutions.\textsuperscript{313} Thus, in case law, efforts to reach a sound level of liability have been wiped out by the inflexibility of judges by their rigid devotion to the restrictive characteristics of the doctrine of veil piercing. It can easily be stated that, in the field of general corporate law, the English and American courts are still attached to a traditional piercing the corporate veil doctrine, which requires a situation of parent company's control over the subsidiary together with some form of unlawful action. In some cases the requirements were relaxed by creating relatively better principles in terms of group liability in order to adjust parent liability concepts to more particular and flexible policies underlying tort and environmental law. However, on the whole, because of the persistent devotion to the limited liability principles of the \textit{Salomon} doctrine, the common law attempts to control the exploitation of the limited liability form has proved unproductive.\textsuperscript{314}

The examination of comparative case law from different jurisdictions produces a result not much different to that of the English case law. The basic requirements of parent's control over subsidiary and intent to fraud have been interpreted in a similar manner. Accordingly, in order to establish liability on a group basis for certain behaviours, one needs to prove the existence of control of parent over the subsidiary and intent of misuse of the relationship between subsidiary and other companies in the group. Control has been considered, as a structural relation similar to property and it is distinguished from rule.\textsuperscript{315} In practice, control is applied by powers of decision-making. Accordingly, there have been some efforts in case law in order to ease requirement of control theory for broader liability of the parent. For example the ‘supposed control’

\textsuperscript{313} Dine, \textit{The Governance}. p. 44 (n 23)
\textsuperscript{314} Griffin, Limited Liability. (n 6)
\textsuperscript{315} Scott John, 'Corporate Groups and Network Structure' in McCahery J, Picciotto S and Scott S. (eds). \textit{Corporate Control and Accountability} (OUP, Oxford 1993)
theory in EU competition law cases and 'authority to control or supposed control in German qualified de facto group concern or 'capacity to control' in CERCLA transfer the burden of proof from plaintiffs to the parent. Moreover, a search for the true intent of the parties by applying group of companies' doctrine in international commercial arbitration cases provides some broad discussion in the area of liability of corporate groups. However, all these efforts have been undermined by the subsequent developments because there has always been a strong resistance to fundamental changes in principles of company law.

The underlying reasons for failure can be found in the reality of misunderstanding of the structural characteristics of corporate groups and MNEs. The efforts to create group liability mostly aim to create kinds of compensation regimes for unsatisfied creditors of subsidiaries. Thus, many regulations fail to find a solution for subsidiaries' torts since the separate legal personality theory allows the parent to escape liability. Accordingly, the concentration for better liability regimes in MNEs context must be on bringing the separate legal personality theory of law together with the separate personality theory in economic and business studies.

The lack of modern and comprehensive understandings of groups of companies, especially from the perspective of MNEs, prevents scholars, practitioners, courts as well as parliaments from developing satisfactory regulations. Even the latest attempts to regulate corporate groups such as Draft Commercial Law Bill in Turkey and new Companies Act of England as well as EU Action Plan fall into the same mistake, which is conceptualising corporate groups as vertical organisations.

Thus, the main obstacle to reaching to broad liability rules is the same in both statutory and case law which is always complicated by a search for control over one company by the other in a group. This is a direct result of misconception of the functioning and structure of corporate groups. In the previous chapters, the extensive search to establish the modern structure has indicated different facts than those
conceived by the court or lawmakers. The control in a modern horizontal organisation is spread over subsidiaries. Each company under the group has broader independence and the control is exercised through group culture and principles rather than apparent involvement on daily decision taking. Therefore, management instructions might come not only from centre of the group but also from those who have various specific duties to perform for the group. Consequently, the requirements of control that is imposed by the statutes and courts are mostly invisible from outside. Thus, all the regulatory efforts based on control theory are incompetent in practice.

Another problem of existing regulation is the persistent ignorance of involuntarily creditors in MNEs torts. None of the statutory laws aim to solve the problems of tort liability. There is a complete negligence of the issues in contrast to huge public debate. Victims of MNEs torts are left with no solutions because there is no efficient mechanism to look for comprehensive liability on a group basis.

In conclusion, this broad examination of existing regulations and principles in law can be concluded in a way that there have been many efforts to remove the unjust effects of limited liability for corporate groups but none of them has accomplished the long-waited breakthrough revolution. In other words, none of the regulations or outcomes of case law created principles are able match the economic, managerial and social dynamic of groups of companies and MNEs. Thus, the reconsideration of principles of company law with the aim of creating better regime of corporate group liability must be conducted. For this purpose, broad examination of existing law must be used as illustrative models to indicate the failures in the area. The final striking outcome of this chapter is the indication of the need for better-structured proposals in the area to offer an adequate framework for assuring MNEs tort liability.

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316 Detailed discussion is made at chapter 2.
CHAPTER V: FUTURE OF MNEs' TORT LIABILITY

In the previous chapters, the thesis has indicated the problems of MNEs' tort liability. The torts committed by subsidiaries of MNEs are discussed and gaps in the legal systems are indicated by concluding that MNEs might avoid liability in tort and this problem is urgent and requires attention from academics, parliaments and judges. For this purpose, the thesis first indicates the distinguishing characteristics of MNEs from other institutions by examining developments in legal, social-economical and managerial-structural characteristics. Accordingly, the thesis claims that an MNE is a distinct institution, which is unique in its characteristics and thus different from other institutions recognised by laws and thus requires different regulatory principles and theories. Accordingly, chapters three and four are devoted to search for laws and regulations on MNEs liability issues. The thesis demonstrated that the laws and regulations are inefficient to solve the liability problems due to common misunderstandings of interdisciplinary characteristics of MNEs. As a result, even though the time has come to think about real, effective and internationally applicable solutions for the MNEs' liability problems, so far no concrete proposal exists for such a solution and governments seem unwilling to commit themselves truly to a legislative solution.\(^1\)

From an academic perspective, the solutions suggestions have always had weaknesses if they are not totally ineffectual. Accordingly, the aim of this chapter is to propose the framework principles on which MNEs tort liability must be built. The principles will be based on a combination of social, economical and managerial characteristics of MNEs with the particular focus on the problems of MNEs tort liability.

While doing that, the thesis focuses on the examination of liability in core areas of law, in other words, laws that are enforceable through states' court systems. Therefore,

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\(^1\) Gleichmann K., 'The Law Of Corporate Groups' In The European Community' in Sugarman, D. & Teubner, G. Ed. Regulating Corporate Groups in Europe (Nomos, Baden-Baden 1990)
the voluntarily approaches to corporate groups liability is excluded in this study. Moreover, the laws with public international law characteristics, e.g. criminal law, have also been excluded.

Excluding the examinations of public law and voluntary regulation options is based on practical and academic reasons. The practical reason is that there is need for limitation of a subject in a research project, which is limited by time and space. Moreover there are many research projects devoted to voluntarily approach to corporate liability under the titles of corporate social responsibility (CSR) and codes of conduct. Similarly, forcing liability by using public law tools has completely different characteristics and studies on it as well are quite widely done in various institutions. The academic reasons for the exclusion of public law and voluntary regulatory approaches to MNEs tort liability is based on the fact that there are certain differences between the scope of this research and voluntary liability approaches. The voluntary approach tries to prevent corporate torts or any illegal and moral misbehaviour while the liability approach in this thesis aims to compensate or provide a justifiable liability for the torts committed by MNEs. In this case, principles and tools are fundamentally different; the voluntary approach requires a consideration of a number of policy and economic issues and soft law principles while the obligatory liability system requires mostly hard law and fundamental changes in statutes and case law.

Moreover, even if MNEs behave in a very good manner or follow their CSR very closely, there is always the possibility for torts to happen. Nobody can guarantee that, even under very stringent regulations, MNEs behave in a good manner and there will not be another tragedy caused by torts committed by subsidiaries of MNEs. Thus, this thesis claims that the best way to achieve justice in MNEs tort cases is to balance profit-maximisation theory with liability-expansion through creating efficient liability regimes and thus maximising the compensation paid for tort. In other words, a liability regime based on hard law is the most efficient ways to hold the balance between the economic theory of profit maximisation and requirements of justice in the law. I believe that CSR and other voluntary regulatory approaches might not create the expected level of a
justifiable regime to regulate MNEs, even though they would surely have some positive effects.

One of the aspects of liability issues relating to MNEs is whether liability should aim to protect people against MNEs tort or must it concentrate on compensating the victims for committed torts. In the first instance, the logical answer seems to be that the aim of any regulation must be preventing corporate torts before they happen but on careful examination it is not that easy. The protective measures already exist and there are many recent developments in environmental, labour or tort law that aim to prevent MNEs torts. However, these measures are two sided, in developed countries preventative measures might work better than they work in less developed countries. And less developed countries are systematically prevented from taking more preventative measures since they are scared of loosing MNEs investments in their countries. On the other hand, even though there are very detailed rules to prevent MNEs' misbehaving, there is still very high likelihood of torts committed by MNEs. To be able minimise the effect of the MNEs torts, there is a need of system of liability aiming to compensate victims in a full and justifiable way.

The effects of efficient liability systems will be two sided: first, it will create justifiable solutions for victims after torts have been committed which is the basic aim of every legal system. Secondly, compensation maximisation will have an important effect on preventing and deterring MNEs from misbehaving and committing torts. In other words, searching for compensation maximisation is not just searching for efficient ways to compensate after tort; it is, with the same importance, finding effective ways of prevention of corporate groups torts by creating a solid liability regime. It is widely proven in many situations that an efficient liability regime prevents many torts by forcing companies to take necessary measures to avoid it. For example, liability imposed on companies for the use of asbestos has made them very careful in their mining operation: a newspaper report states: "there was a good lesson learnt by companies since
more than 80 companies went bankrupt; the use of deadly asbestos has now completely been abandoned in the USA and many more countries follow this practice”. It is very obvious that one of the reasons for this was high compensation awarded by the American courts. Moreover, in the case of purchasing insurance for the risk of companies operations, insurance companies will require high preventative measures or will sell the insurance at very high prices since the assessment of the risk will be made according to the new liability rules. Accordingly, the aim of liability regimes must be creating compensation maximisation, under which MNEs will be expected to pay high compensation to tort victims.

With this aim, this chapter will be devoted to searching for better liability regimes for groups of companies and thus, for MNEs. However, there will not be completely clear-cut proposals in order to avoid a complex system of proposals that will have little chance of being considered by regulators. Rather, the aim will be determination of principles and theories on which MNEs liability regulations must be built so that the regulatory discussions will be comprehensive enough to solve current and future problems. Principle creating in the first instance will increase the chances of reaching a more global and widespread regime of liability.

Accordingly, in this chapter firstly, there is indication of the basic difficulties, which explain why the expected level of protection could not be achieved for MNEs tort victims. A number of obstacles will be discussed to clear the way for understanding of future developments. Acknowledging the difficulties will be very helpful in creating better proposals and helps us avoiding mistakes made in the past. Secondly, the solution suggested outside corporate laws will be discussed briefly in order to test their efficiency. Finally, there will be a search for a number of options by comparing existing laws and principles and solutions offered on the principles discussed in this thesis: the

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suggestions will be built on the facts discussed in the second chapter of the thesis and will be associated with the findings in third and fourth chapter. However, there will be no attempt to create precise codes in order not to fall in contradictions of our claims that MNEs are dynamic institutions and must be regulated according to their contemporary realities. Taking this approach will make the life of the suggestions longer and will give this study a broader characteristic and, more importantly, a guiding mission.

Difficulties and Obstacles to Imposing MNEs' Tort Liability

At this stage, it is vital to provide a basic explanation why the apparent injustice in current legal order could not been overcome for such a long time. In other words, one should search for what the difficulties are behind this rigid situation since case and statutory laws do not offer any solutions to MNEs' torts.

The first difficulty on the way to achieve comprehensive MNEs liability is the lack of empirical research to assess what would happen if there were no limited liability since on this stage all forecasts of the economic system of companies without limited liability are subjective and depend on non-empirical prediction. Therefore, in the absence of influential experimental research any conclusion has to remain spontaneous and unverified. It is suggested that, from an economic points of view, the abolition of limited liability for corporate groups' torts would result in a level of damage to the financing of business enterprise, which would sooner or later be seen, to be unacceptable. Accordingly, liability rules dependant on this non-empirical prediction have been inefficient since they either offer some changes under current regime of liabilities or search for alternative options outside the range of company law principles. Thus, there has always been a search for solutions that do not touch the core principles

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However, not having empirical data must not be an excuse since the legal system should begin to collect empirical data by starting a gradual elimination of limited liability. It must start with the most urgent and justified case: abandoning limited liability for the benefit of tort victims in the context of corporate shareholders since there are number of indications mentioned in second chapter that prove that abandoning limited liability for corporate shareholders might not fundamentally disturb capital market economies. Moreover, some case and statutory law examples from comparative jurisdictions have created empirical data. Thus, it can be claimed that, non-availability of empirical data cannot be an excuse for not solving liability problems in corporate groups’ context.

One of the basic reasons for failure is that limited liability company is considered as one of the driving forces of modern capital economies putting it at the centre of market-economy regulations. This requires that, in order to solve the problems, the theories in legal and economic studies must be dealt together by bringing social justice theory into this frame. Thus, there is a requirement to create a better background theory and justification not only in legal but also in economic and political and social aspects of limited liability. With this aim, this study indicates that limited liability in the corporate groups and MNEs context play little role in investment decisions and the functioning of market economies. As a result, economic, social and political theories of MNEs have been built to consider options for liability regimes in MNEs context.

The effect of limited liability differs according to types of shareholders: individual shareholders need the protection of limited liability more than company shareholders. This brings us the discussion to the conception of shareholders. In academia and in case law, shareholders are considered as innocent participants in the modern capital economies. In need of protection, shareholders are considered almost on the same level as creditors creating a situation that in a sense no solution can be perfect because group responsibility laws will often compensate one group of innocent parties (that is the shareholders and or creditors of the compensated group member) at the expense of

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5 Pettet. Limited Liability. (n 4)
another group of innocent parties (that is the shareholders and/or creditors of the liable group members). In order to avoid this protectionism of shareholders, the conception of corporate shareholders must be differentiated from individual shareholders. Accordingly, in this thesis, there has been a mission to differentiate between corporate shareholders and individual shareholders in corporate groups' concept by claiming that the law should take a different approach towards individual shareholders and company shareholders in terms of application of limited liability since different treatment and structure of corporate shareholders and individual shareholders is already a common practice in the market economies.

The deadlock created by strict devotion to limited liability in the corporate concept switched some attention to corporate directors. Diverting our attention to the directors will be eradicated by the principles of limited liability since making them liable outside of their personal misconduct seems unfair while real owners of the companies can avoid liability. Thus, from a legal and economic point of view, making directors liable for torts committed in the course of management of the company is inefficient because development of liability of directors for tort is peculiar to the idea of efficient balancing of risk that the doctrine of limited resource aims to achieve. Moreover, although director's liability provisions have been widely adopted, and more generously proposed neither legislators nor courts have managed any clear articulation of the basis on which they may be explained. There is a contrast in the law: if there is liability imposed on managers of the companies who are working for the benefits of shareholders, there must be liability for shareholders as well. Therefore, it can be claimed that liability imposed on directors differs in principle from the liability imposed on corporate groups or shareholders, either company shareholders or individual shareholders since directors are employed by shareholders to operate companies' daily business and thus, they must be considered employees of the shareholders; for this reasons, making the employees liable

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7 Grantham Ross and Rickett Charlie, 'the Bootmaker's Legacy To Company Law Doctrine' in Grantham Ross and Rickett Charlie (eds.), Corporate personality in the 20th century (Hart, Oxford 1998)
rather than employers seem unfair. Moreover, it is apparent that, even in case of full personal liability of directors, the expected level of protection will not be achieved because of the limited funds of directors and easy avoidance of liability by indication that the directors performed their basic legal duties, which is maximising the profit of the company.

Another difficulty which explains failure to create a functioning corporate group liability for tort was that under the complex structure of corporate groups, the unclear nature of laws applied to groups have caused the confusion to which legal body in the group victims should address their claims. This creates a difficulty for regulators finding a legal person to impose liability on. As a result, liability models have always concentrated on making parent companies liable under different systems and principles. These models to reach parent as only logical legal personality to have liability in the group have been at the centre of proposals. The reason for this is that when liability issues for MNEs and group of companies started to be considered in academia, in practice and by lawmakers, almost all the proposals, either successful or not, have been depended on this simple approach to MNEs structure, under which it is assumed that parent applies direct control over its subsidiaries.

Accordingly, the extent to which liability of the parent requires specific regulations and the conditions of such a specific group liability are very controversial indeed. There have been three different kinds of liability tried to be imposed on the parent. In a simple approach to groups of companies there is a tendency to hold the parent liable for damages inflicted on the subsidiary provided that there was fault, such as in the piercing the veil principles. A second pattern of liability is the assumption of the subsidiary's losses by the parent at the end of the year (approaches taken by German, French and European regulators). Alternatively the law may attach a direct liability on

8 Grantham and Rickett, the Bootmaker's Legacy. (n 7)
the parent corporation by reason of its failure to exercise proper control over its subsidiary (vicarious liability).

Legal complication in regulation of corporate groups and difficulty of finding legal persons on whom to impose liability has resulted in many variations in legal and academic principles suggested to solve the liability problems. In all those approaches, the basic justification was control of the parent over subsidiaries: that control gives rise to the legal obligation of the parent to the plaintiff. Since there are no critical approaches to group of companies' structure and organisations those principles have fallen into the same models of laws that have already proven inefficient. Interestingly, once alternatives have proved inefficient, the searches have intensified and created more detailed proposals on the same economic and structural symbolization of corporate groups. We have already seen many examples in case and statutory laws but some examples of variations in proposals made by academics considered alternatives to statutory and case-law-created veil piercing doctrine are worth mentioning.

The first alternative proposal would be to impose liability on parent corporations where their subsidiaries have exposed others to knowable risks and are now unable to cover their liabilities for damages caused by these knowable risks. Professor Schwartz' proposed rule would impose unlimited liability for corporate torts only in the context of knowable, but not remote, risks. The proposal would draw a distinction between the different types of risk, and impose parent corporation liability only for knowable risks. This approach claims to have comparative fairness and efficiency in application, because it encourages the discovery of risks and punishes the parent corporation only when it

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12 Schwartz Alan, 'Products Liability, Corporate Structure, And Bankruptcy: Toxic Substances And The Remote Risk Relationship' (1985) 14 Journal of Legal Studies 689 defines a knowable risk as "a risk that a product is as dangerous as a firm would predict on the basis of doing the cost-effective amount of research, or less dangerous. Conversely, a remote risk is a risk that a product is more dangerous than a firm would predict if it had done the cost-effective amount of research into safety".
places a knowable risky activity in a subsidiary corporation without placing sufficient assets into the subsidiary.13

However, in practice, the liability of the parent only for knowable risk cannot actually create a better solution than veil piercing doctrine. Under complex horizontal structures of MNEs, it is unclear and almost impossible to prove to what extent the parent was aware of the activities of subsidiaries. Moreover, the evaluation of risk by the parent and by the subsidiary could be completely different since subsidiaries are more independent and self-operated. Under those conditions, to be able to apply liability for knowable risk, the courts have to engage in very fact-specific inquiries of the situation between the parent and the subsidiary similar to one in veil piercing doctrine.

Alternatively, Professor Dent proposes that liability should be imposed on negligent controlling persons, but not on cautious ones.14 Dent suggests an alternative to current parent corporation liability standards that would encourage, rather than discourage, active involvement of the parent corporation in the operations of the subsidiary. The firm members can avoid personal liability by showing that the firm implemented reasonable measures and procedures to control the conduct that caused the loss. Therefore, firm members can escape personal liability if they can affirmatively show that they acted reasonably in managing risk.15 Dent explains that the standard of the cautious parent corporation should not require the monitoring of day-to-day activities of the firm but will require that parent corporations make sure that the subsidiary retains capable officers who install a reasonable program to prevent subsidiaries' fraud. This prudence standard or approach would further require that the parent corporation assure financial soundness the determination of which would be left to the courts where several factors should be relevant.16 Dent tries to change the traditional parent-subsidiary

16 Fortney, Seeking Shelter. (n 15)
liability concept by encouraging parental control, not discouraging it. Therefore, this new approach to parent corporation liability seems more in tune with the objectives of CERCLA and existing tort law, which were criticised earlier in the thesis for causing more complexity. Moreover, as already tested by many failed statutes and proposals, the encouragement of control has been far from creating solutions and completely in contradiction to the direction of contemporary changes in groups structures under which the control is decentralised.

An alternative solution suggested is parent corporation liability for equipping the subsidiary with insufficient assets. Gelb proposes that in cases where creditors are unable to protect themselves, such as tort creditors, the adequacy of the corporation's assets should be the relevant inquiry. The court's focus should be on the adequacy of assets, and the term under-capitalization should be abandoned in favour of this new description because capitalisation may overly focus a court's attention on assets provided to a corporation as capital at the time of its organisation. Consequently, there must be a continuing requirement for the maintenance of an adequate level of assets and not one based solely on the assets situation at the commencement of the business. Gelb concludes his proposal by defending the adequacy of assets approach, stating that consideration of other traditional factors is unnecessary, irrelevant and may lead to error.

Courts and commentators often cite inadequate capitalisation as an important factor in the corporate veil piercing analysis. However, empirical analysis of the case law suggests that inadequate capitalisation in practice is not as persistent an issue as the commentators would suggest. Thus, minimum capital requirements arguments also seem not very convincing, since it could be claimed that it has more importance in small-scale private limited companies rather than huge networked MNEs. Moreover.

17 Gelb Harvey, 'Piercing The Corporate Veil--The Undercapitalization Factor' 1982 Chicago-Kent Law Review 1
18 Gelb, Piercing The Corporate Veil, (n 17)
minimum capital has already existed in many jurisdictions but it has not created a solution to the corporate groups' liability. Moreover, evaluating the adequacy of asset requires complicated and demanding work before the corporate veil can be disregarded. In this respect, Gelb's proposed standard presents a less dramatic shift from current veil piercing doctrine, narrowing the range of factors necessary to pierce the corporate veil, but still requiring a fact-specific, *sui generis* inquiry in each individual case.²⁰

As a result, the examples of proposals on the concept of parent-subsidiary relationship for the basis of liability cannot provide adequate solutions to the problems because they ignore the economic and managerial realities of modern corporate groups. The above mentioned and similar proposals somehow have been tested in different jurisdictions but mostly failed to create dramatic improvements in the MNEs tort liability situation. The scholars have failed to grasp the common interdisciplinary characteristics of corporate groups and MNEs so the overall outcome of their proposals produced very complex structure of liability, which requires a number of conditions and are simply very easy to evade by MNEs. This created a circle in which already tested liability proposals have been reintroduced with different names but the same principles with different shapes. Therefore, in order to be progressive, the lawmakers, courts and scholars should search for liability options by considering interdisciplinary characteristics of MNEs.

Moreover, liability options offered by scholars are usually compensatory liability by parent company rather than direct liability of the parent or group. Thus, liability directed to the parent is not efficient in MNEs context. The jurisdictional differences between countries and different approaches to liability in a subsidiaries' jurisdiction make it very difficult to create a group based liability if a parent's liability is considered as compensatory rather than direct liability.

²⁰ Farmer, Parent Corporation, (n 13)
Liability Options outside Corporate Law

The strict principles of company law have caused problems in the MNEs tort liability context. Therefore, scholars and regulators are searching for relief of the MNEs tort problems outside the company law sphere as alternatives to deadlock in company law principles. 21 Here, I just want to discuss some examples of alternative solutions suggested to the MNEs tort problems: mandatory insurance, parent guarantee for subsidiaries debt, and changes in insolvency laws.

The preference in favour of involuntarily creditors in insolvency can be considered as a solution to tort liability problems for group of companies. Leebron and Thompson have argued that financial creditors should be deferred to tort claimants in a liquidation procedure. 22 Professor Davies as well suggested that in some jurisdictions, part of a solution to the group problem is to be found in insolvency law, where the court may be given discretion in certain circumstances to bring a solvent company in the group into the insolvency of another company in that group. 23 However, this option is very shallow since changes in insolvency law will not fundamentally affect the liability issues discussed in the thesis; deferring involuntarily creditors to voluntarily creditors would just improve the conditions of involuntarily creditors rather than solving any problems. Moreover, this option might work only in small-scale domestic operating corporate groups since the application of insolvency would be much more problematic in big corporate groups and MNEs. Thus, deferring involuntarily creditors in insolvency will have a very little influence on the current situation. However, the differentiation of creditors should be made when discussing MNEs liability; involuntarily creditors should

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22 Leebron David W. ‘Limited Liability, Tort Victims, and Creditors’ (1991) 91 Colum L Rev 1565 and Thompson, Piercing the Corporate Veil (n 19)

23 Davies Paul L. *Gower and Davies’ Principles of Modern Company Law* (Sweet & Maxwell, 2003 London) p. 205
be treated differently in application of liability rather than waiting until the insolvency procedure.

Alternatively, the theory of business might suggest that the key to all liability problems in MNEs activities does lie with insurance. Accordingly, laws requiring MNEs to purchase liability insurance against tort claims to the extent that the claims overvalue their assets is suggested. How it should be done could only be determined after extensive consultation with the insurance industry, carried out by relevant regulatory bodies. On a basic level, small companies can be liable up to a set amount covered by insurance while big companies, which deal with hazardous activities, will make a detailed assessment of the risk.24

Accordingly, to some extent, insurance can create solutions to compensation problems in MNEs tort. However, insuring corporate groups who are engaged with extremely hazardous business would be very expensive. Therefore, a big majority of the companies will refuse to do business in the areas considered dangerous, which might create a monopoly in the hazardous business area. Monopoly in international business and investment would make the current situation worse. Moreover, there is another problem that insured companies might conduct their business very carelessly, since the insurance is already very costly, the companies will not be willing to spend more money for safety measures. Possible devastating effect on insurance companies should not be ignored. For example, in an incident like one in Bhopal any insurance company could hardly pay the huge economic damage.

Insurance options must be questioned from the perspective of liability. Even if there were sufficient insurance it will just cover the compensation determined by the courts or agreed by the parties, rather than creating a liability regime for an entire networked corporate group. However, in this thesis, the aim is to create a liability regime on a group basis not just a find a way to finance the compensation. Looking back to some tort examples, it can be seen that compensation had already been paid in such

24 Pettet, Limited Liability, (n 4)
cases as in the Bhopal tragedy where the company paid the agreed amount. However, the problems are still not solved in a fair way, thus, there is a need for more fundamental changes in corporate law systems of liability.

Another problem with insurance option would be the question of who will arrange insurance, the subsidiary or parent. If a parent corporation has to insure subsidiaries, the problem of insurable interest would arise. Moreover, insurance is a business preference for companies and each individual entity should insure their own activities and there is no mechanism to guarantee this worldwide. There are two different persons so the parent company cannot have an insurable interest in the subsidiary according to the principles established under the case Macaura.25 As a result, for a successful insurance protection of corporate victims the system must force insurance of corporate groups as whole. However, enforcing insurance on corporate groups as whole will require the same laws and regulations as imposing liability on them: which must be built ignoring the corporate veil and treating corporate groups as single personality. Moreover, the existence of limited liability in the corporate group concept and case like Adams v Cape industries support the idea that corporations are free to split up their enterprises into smaller entities to avoid liability. Under those conditions, groups' purchase of insurance seems inconsistent with general principles since shareholders are already protected from liability claims. Thus investors should not be willing to pay insurers to reduce risk as it can be clearly stated "why buy something you already have for free".26

Above-mentioned suggestions are just the chief examples; there are number of different suggestions. For example, those dealing with an undercapitalised company in a group of companies may obtain a guarantee from the parent company. Or, less securely, the parent company may issue a letter of comfort to the subsidiary’s accounts on a going concern basis, or to a third party contemplating contracting with the

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25 Macaura v Northern Assurance Co Ltd [1925] AC 619
26 Easterbrook and Fischel, the Economic Structure, p. 54 (n 21)
company. These options do not create liability either; they just create better protection mostly for voluntarily creditors.

Because of the apparent difficulty of creating laws in the area of MNEs' liability voluntary regulations can be seen as alternative. The claim is that market and business should be free to consider self-regulation which is much-discussed topic especially in recent years while attracting very controversial reactions. Therefore, it is a fact that there is huge public, media and NGOs attention together with business enthusiasm on the issue of corporate social responsibility (CSR) while the topic is also attracting many academic studies. It has also been very broadly advertised by the industry and MNEs as alternatives to the statutory regulations. Not only business is supporting voluntarily regulations but also some governments and international organisations are in favour of the voluntarily regulations.

Even though the topic of voluntarily regulations is very popular, the nature of voluntarily regulations is not very clear because there is no single guide to CSRs. Therefore, the reactions to the issues are very diverse; one argument is that it is just a public relations issue for huge MNEs; companies use CSRs as an advertisement tools to increase their profits. On the other side of the arguments, CSR is considered as a result of public pressure that in some cases voluntary codes force MNEs to behave in a lawful

27 Davies, Gower and Davies' Principles p.185 (n 23)
28 Dine, Companies, chapter 5 (n 2)
29 DFID and Corporate Social Responsibility, the Government’s Role: Legislation and Voluntary Initiatives, (DFID), (September 2003) p. 9 UK’s department for International Development (DFID) says: “internationally legally binding frameworks for multinational enterprises may divert attention and energy from encouraging corporate social responsibility and towards legal process.” Business groups and international institutions such as OECD also support self-regulation. Despite the UK’s position that company behaviour is best deal with through voluntary approaches, past experience shown that it is not enough.
30 For example, the British government is still a vocal supporter of voluntarism. The voluntary approach is widely endorsed by European governments as well. The UK government has appointed Stephen Timms (MP) as the minister for corporate social responsibility within the Department of Trade and Industry (DTI) his view is that the role of governments is to “work with the corporate sector to facilitate this type of involvement, rather than looking to regulatory measures or new law. His speech can be found at http://www.dti.gov.uk/ministers/archived/Timms131202.html#related
manner and thus prevent much misbehaviour of MNEs in host countries. Although being highly promoted, it is a fact that the CSR has not been put to a real test yet.\textsuperscript{32} Since there are no binding or powerfully accepted uniform codes for the business, every MNE claims their own codes and of course they report complete compliance with fantastic achievements.

In the voluntary approach, companies are concerned with their own reputations, with the potential damage of public campaigns directed against them, and overwhelmingly, with the desire to secure ever-greater profits. None of this necessarily means that companies do not act responsibly. But it does mean that their attempts to do so likely to be partial, short term and inconsistent leaving vulnerable poor communities at risk.\textsuperscript{33} For many companies, corporate social responsibility has become at best an advertisement exercise and at worst a tool for opposing regulation. But both also demonstrate the continued determination of the voluntary sector to make it work properly and their commitment to exposing its misuse.\textsuperscript{34} Simply, many companies have found that CSR has often had a positive impact on corporate profits. Of all the topics related to CSRs, so far, the greatest amount of experimental data links practical companies with positive financial results.\textsuperscript{35}

Accordingly, self-regulation fails to prevent continued abuses of corporate power, and thus corporate torts, for a number of reasons: 1- they do not provide strong incentives for compliance to balance the financial incentives for non-compliance because sanctions are missing or weak. 2- they rely on the appearance of compliance through self-regulation, without even independent confirmation or enforcement. 3- they fail to authorise citizens and stakeholders in the matter; instead, even where a


\textsuperscript{34} \textit{The Times} (London 02 February 2004)

\textsuperscript{35} Mazurkiewicz, Corporate Environmental Responsibility, (n 32)
stakeholder discussion approaches is used, they present the issue of corporate responsibility as top-down- as defined by the company.36

From the perspective of this study, it can be claimed that arguments of voluntary regulations should not challenge or affect outcome of the present study. Actually, voluntary regulations and statutory regulations must co-exist. Successful voluntary regulations have the characteristic of preventing mass-misbehaviours by corporations because they establish standards for the industry, workers, and directors and so on. Consequently, CSRs or codes of conduct might reduce tortious action and tort claims against MNEs, which will make liability regulations much more applicable since the number of claims will be reduced and there will always be possibility to compare well-behaving MNEs and tort committing MNEs. However, it should not be forgotten that the existence of CSRs will not eliminate tort since tort is a reality of life and in some cases it might happen in situations beyond the control of company or directors. Therefore, voluntary regulation and statutory regulations should not be considered as substitutes to each other; rather they should be evaluated as supporters of each other’s applicability and efficiency. Therefore, the legal systems should still develop affective obligatory statutes and laws to create core principles and regulations for MNEs liability issues.

Efforts of international organisations have also attracted many reactions either positive or negative. The OECD has published the OECD Guidelines for Multinational Enterprise37 and OECD Principles of Corporate Governance 2004.38 The International Labour Organisation (ILO) adopted the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.39 Recently the UN has different working

37 OECD Guidelines for Multinational Enterprise (2000) available at http://www.oecd.org/document/29/0,2340,en_2649_34889_2439005_1_1_1,00.html
groups and projects in the area of MNEs\textsuperscript{40} and the UN has produced Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights.\textsuperscript{41} The aim of these attempts is to bring some harmonisations and clear general principles to MNEs activities. These attempts seem to promise creating awareness in the public to force companies to have more responsibility as a group. However, the outcomes of these regulations seem to be insufficient to abolish torts committed by MNEs. In order to stop the committing of further torts by MNEs, there should be efficient legal regulations that create full legal liability in a deterrent way.\textsuperscript{42}

In conclusion, the idea of codes of conduct and self-regulation for companies has no legal basis. It leaves everything to the wish of companies since it does not abandon using company law principles to avoid liability. That is one of the reasons MNEs support corporate CSRs as alternative to liability rules. However, the level of protection for tort victims cannot be provided by CSRs or codes of conduct. Thus, states should not risk the safety of their people by supporting MNEs' policies.

As seen many of the alternative suggestions for liability offer solutions that are outside of the sphere of company law. These options mostly have limited applicability or are mostly applicable for voluntarily creditors since it requires assessments of conditions in advance. Thus, it can be stated that those alternative options are useful in practice for conducting business transactions between companies and creditors but they lack comprehensive principles to solve the problem of tort liability. Moreover, even the alternatives outside sphere of company law have problems with assessing the nature of corporate groups and MNEs as is apparent in the insurance or parent guarantee proposals. All are based on the corporate groups have been perceived as vertical organisations.

\textsuperscript{40} Detailed data are available at http://www.un.org/partners/business/index.asp accessed 23 August 2006  
Future of MNE’s Tort Liability

In the previous chapters, the background knowledge and discussions have been built to be able to facilitate emergence of principles for the most efficient liability regime for MNEs’ torts. The previous discussion suggests the law is inadequate to solve the problems that corporate groups and MNEs create. Thus, current legal systems should take action to regulate tort liability of corporate groups and MNEs by elucidating the basic principles for liability regimes for corporate groups. As a result, the thesis next searches for answers to the question of which types of regulations are best suited to corporate groups and MNEs’ liability problems. These discussions are made from different perspectives.

The first principles to discuss must be the ground for liability (jurisdictional concerns). The jurisdiction for an effective liability regime (global, international, regional or national level) is important since globalisation of international economic activities has created new challenges for lawmakers. Domestic civil laws have failed to solve the problems or rather have become obstacles to solving some civil liability problems created by the activities of globalised civil actors. Therefore, in order to create efficient civil liability regimes, there must be a search for regulations valid at global level. However, this seems very difficult at the moment because of the economic differences and development inequalities amongst countries as well as differentiated roles of MNEs by creating huge disputes among countries according to their interests. This heterogenic structure of countries is an obstacle to reaching a global regime of civil liability, which proposes that consideration of regional or domestic regimes with more global effect will be more realistic.

In regional concerns, the EU might offer some provincial regulatory schemes that guarantee civil liabilities of any parties who are exposed to a tort by a member of a group of companies. Efficient regimes in the EU might have external effect by imposing
liability on EU based MNEs for their tort outside the EU. Moreover, if an EU member state were to introduce group liability for tort, the ECJ’s rulings in Daily Mail\textsuperscript{45}, Centros\textsuperscript{44}, Überseering\textsuperscript{45}, and Inspire Art\textsuperscript{46} cases would guarantee that circumvention of this regime by setting up a company in another member state might not be considered an abuse of the freedom of establishment regulated in the EU Treaty.\textsuperscript{48} Thus, any possible introduction of liability at the EU level will prevent avoidance of the regulatory competition amongst members to attract more companies to establish in their jurisdiction since regulatory competition is one of the biggest obstacles to introducing an accepted level of liability regimes in any particular country. Thus, the ideal regulation must be able to reduce the possible regulatory competition by designing regulations that are widely accepted.

Moreover, the complexity of the area of MNEs liability also favor regulation based on standards to create better applicability. In this the EU can provide the most efficient regulation for corporate groups, since it focuses on creating standards-based law and leaving the role of improvements to member states. Accordingly, the EU must start a broader initiative than its current Action Plan on Modernising Company Law to reduce the severe affect of MNEs torts. Actually, the EU should start a new project on this matter either as part of the Action Plan or completely independent from it.

It is useful at this level to mention the discussion of the nature of possible EU action; at the EU level there is a discussion in the case of unitary regulation as whether it must be obligatory for every state or states to be given a right to opt out from this regulation or some part of the regulation. The self-determination even by states is always supported by business organisations, which might create possible corporate heavens.

\textsuperscript{44} ECJ Case 81/87 of 27 September 1988, ECR 1988, 5483

\textsuperscript{45} ECJ Case C-212/97 of 9 March 1999, ECR 1999, 1-1459

\textsuperscript{46} ECJ Case C-208/00 of 5 November 2002, ECR 2000, 1-9919

\textsuperscript{48} See Andenas Mads, ‘Free Movement of Companies’ (2003) L.Q.R. 221

\textsuperscript{47} Berkamp L. and Pak Wan-Q, ‘Piercing the Corporate Veil: Shareholder Liability for Corporate Torts’ (2001) 8 Maastricht J. Of European And Comparative Law 167
similar to Delaware in the US. However, allowing this to happen would result in the emergence of regulatory competition, which any regulation should aim to avoid in the first place. Thus, the implementation of possible EU based laws should be compulsory for member states, at least so far as the basic principles are concerned.

In the absence and failure of the global and regional regulatory efforts, national corporate laws as well might create the same effects especially in those countries in which MNEs are originated. The law of a certain nation state might grant jurisdiction rights for victims and might create a regime under which victims pursue their civil liability claims in equal ways to citizens of this particular country. Such law will be at domestic level but the influence will be at a global level since it will have the effect that civil liabilities against MNEs might be pursued in domestic courts as well as implementing liability clauses for other member corporations in the group.

In pursuing the aim of creating the widest possible liability regime either at national or regional level, the basic principles of ATCA can be improved to make it an effective regime of tort liability. The basic nature of ATCA, which is creating civil liability for torts committed by the removal of jurisdiction barriers, must be kept but all the obstacles that restrict application of liability must be removed. First of all, the notion of civil liability must be not just sourced from international law but it must cover any tort liability raised against MNEs. The most dramatic aspects of ATCA, which is bringing the case even if the company has only a connection to the state, must be kept so victims can start their liability actions in any jurisdiction where a subsidiary of a group is based. Moreover, application of forum non conveniens must be abandoned as well as the application of veil piercing doctrine in corporate groups must be abandoned to make the rules more efficient.

Accordingly, on the lack of global and regional liability regimes for MNEs, the minimum contact to jurisdiction principle introduced in ATCA litigations can be considered sufficient to eliminate the jurisdictional barriers to victims of MNEs tort. Under this principle, existences of subsidiaries provides a minimum contact in the forum and therefore create a jurisdiction over parent companies, or other companies in the group or on complete group. Thus, the system of minimum contact would work better if
it can be combined with widely accepted group liability. Accordingly, the system of creating jurisdiction based on minimum contacts is better suited to horizontal structures as well. On the lack of clear hierarchy in corporate groups, it is better to try to apply liability not only through parent companies but also through other entities in the group.

After determining the jurisdiction to address the problems it is necessary to argue whether there should be protecting regulation for creditors or regulations should aim to facilitate operations of MNEs (Economic Concern vs. Justice). It is a fact that the efforts to create better liability regime for group of companies and MNEs have always been blocked by the consideration of economic wellbeing of society. There is a common belief in international economic studies that MNE operations in home or host countries are necessary for the economic benefit of people at any level of the society. Thus, the regulations of MNEs activities have mainly concentrated on facilitating their operations or opening up borders to these huge economic powers. Consequently, regulating efforts or tightening liability issues is kept at a minimum level. Accordingly, under the belief and policies shaped by modern capital economic theories, the protective regulations for corporate creditors against MNEs activities are constantly ignored by lawmakers in order not to deter MNEs investing in their territory.

The difficulties appear in the understandings and characteristics of these regulatory approaches: the protective regulatory perspective and the organisational approach demonstrate specific features and are based on different standards. While the former is based on a view of the group as a hazardous institution, the latter regards corporate groups as an entrepreneurial reality, trying to provide them with safe guidelines for their operation and for the ongoing relations between the member entities and amongst their organs. Accordingly, together with the complex economic and managerial feature of the MNEs activities and lack of studies to combine these theories with risky feature of MNEs have caused the current deadlock in MNEs regulation.

The law should come to more comprehensive proposals in order to balance economic need and the need for justice according to social economic analysis built into the previous chapters. Both sides of the regulatory arguments have important concerns thus the legal system should not restrain economic or justice concern for the benefit of
the other. Some situations might require weighing in on the side of regulation of groups to facilitate their economic activities, while some situations require laws that are protecting creditors and victims. For the better and more contemporary regulation of corporate groups, modern law systems should take both approaches in equal measure and try to integrate them into the modern regulatory regime.

Accordingly, the regulatory approach should consider this imbalanced situation while introducing new laws by imposing liability on MNEs. Moreover, the present study has indicated that imposing liability for subsidiaries' torts on MNEs would not result in the collapse of company groups or collapse of any national economy. In the area of MNEs liability, it has already been indicated that the prospective liability imposed on MNEs for their tort in home or host countries is not really unbalancing the economic developments of any nation because of the requirements of justice. In other words, being liable for their subsidiaries' tort will not substantially affect the economic existence of MNEs.

This brings us to the discussion of differentiation amongst shareholders. In a situation that every solution suggestion to MNEs' tort liability problems has been somehow blocked by the limited liability principles, one should think that limited liability should be abandoned completely. Accordingly, the most extreme departure from current legal systems towards liability would be abandoning limited liability and introducing pro-rata shareholders liability for corporate torts or even creating a most dramatic departure by creating unlimited shareholders liability. It is claimed that, a rule of unlimited pro rata liability would protect the marketability of corporate shares without permitting shareholders to externalise the cost of corporate torts.\(^{49}\) This proposal is aiming to abolish limited liability not only for in corporate shareholders but also for individual shareholders, thus it could not attract many supporters.\(^{50}\)


However, abandoning limited liability completely might have very diverse effects on capital market economies. Even though, there is no empirical data to evaluate capital market economies without limited liability, it is obvious that drastically changing a core of the company laws might destroy the structures of modern enterprises. Thus, I believe that the time has not come for discussing complete abolition of limited liability. Even abolishing limited liability for tort victims would have many procedural and practical problems and seems very unlikely to be possible in the near future because it requires much more preparation and empirical testing. Moreover, for the title and purpose of this study it is not necessary to discuss this option very deeply at this stage since the aim pursued in this project is to establish liability for corporate groups’ torts. Thus, I believe the concentration must be on eliminating liability problems in corporate groups, which could provide more empirical data to discuss further elimination of limited liability.

In the process of liability discussions, given basic principles of common law, the discussion of the role of the courts in any regulatory approach will be unavoidable. Thus, there should be question whether the regulation should be statutory or case law. Professor Lowry claims that any shortcomings in limited liability problems can be addressed by the courts being prepared to adopt a bolder and more principled approach to the issue of piercing the corporate veil, which would at least provide a necessary counter-balance against the abuse, which it is claimed Salomon has given rise to.\footnote{Lowry John, ‘In Defence of Salomon: Promoting The Corporate Veil’ in Barry AK., Rider and Mads Andenas (cds) \textit{Developments in European Company Law. Vol 2} 1997: The Quest for an Ideal Legal Form for Small Businesses (Kluwer Law International, London 1999)} Thus, if the universal availability of limited liability does produce abuse, the appropriate solution may well lie with the courts rather than the creation of a new principles of liability. The principle that should guide the courts in determining whether or not to pierce the corporate veil should be firmly based upon notions of justice or more general...
equitable considerations. Only thus will the judges be able to strike the best possible balance between devotion to Salomon and the doctrine of limited liability.  

However, previous examination of the case law in England and comparative examination in US case law prove that leaving liability problems to the courts will not create better results than veil piercing principles. This fact has already been stated in many incidents by courts by addressing the parliaments for fundamental changes. The problem in the case law is the lack of principles and a difficulty in changing their stand on limited liability and Salomon principles. In these conditions, it is difficult for courts to develop a very fundamental departure from old and settled practice without revolutionary interference from parliaments. The parliamentary effort would create basic of regulations to make MNEs liable since it is relatively easier to change the current situation by a statute than changing it by case law. However, the requirement of statutory interference does not mean courts would be inactive in creating and developing liability regimes for MNEs. The creative role of the courts is required at every stage of the practice and for further application of the rules to new and changing situations in the practical world. Therefore, any forthcoming reconsideration of a liability regime should consider both statutes and case law together.

Deciding requirements of statutory intervention triggers another question as to whether there should be single or plural regulation. In strict terms, whether to have a single exclusive regulation or different ways of legally ordering corporate groups within the same legal system is indeed a question that needs to be addressed before the features of group regulation are dealt with. The discussion conducted earlier in this thesis that the regulation of corporate groups has been made under different branches of law and this creates some problems for those who expect some kind of harmony and predictability in law of a particular matter. On the other hand, there is a discussion that corporate groups are of interest not only to company law but a very broad range of laws spread through other branches of law such as competition, tort, labour or insolvency.

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52 Lowry. In Defence of Salomon. (n 51)

43 Irujo José Miguel Embid. 'Trends and Realities in the Law of Corporate Groups' (2005) 6 EBOLR 65
Therefore it is claimed that it will be necessary for other branches of law to have provisions and principles related to corporate groups from their own perspective.

For the purpose and the aim of this thesis, giving some credit to opposite ideas, groups of companies must be regulated under a single law. But it should consider the dynamics of the other branches of law. There is a need for a group of companies' regulation covering MNEs but this law should not be initiated just from the basics of company law. Rather it should possibly consider and take into account experience and principles that have been created under other branches of laws examined in the previous chapters. Corporate groups' law must be comprehensive enough not to require other branches of laws to search for further liability clauses. For example, it must cover and thus offer solutions to the problems of jurisdiction so that there will not be a time-consuming battle to establish jurisdiction on MNEs. The lawmakers should examine how different characteristics of tort, labour, and competition, environments, and human rights laws might give impact in MNEs and group of companies and company laws. Doing so will enrich the basics of MNEs liability laws so that the law will be long-lasting and well equipped in creating more justifiable solutions.

In order to achieve this aim, we should look for an answer to question of whether there should be company law or corporate groups' law or MNEs law. For practical purposes or more importantly for the life of durable regulations of MNEs, the legal regimes should decide whether there should be a new corporate groups law covering MNEs or the law-makers should still regulate group of companies' law under company law. One side of the argument is that there is no need to regulate corporate groups under different principles since they consist of independent companies operating together, but on the other hand, the examination of groups of companies and MNEs as social and economic institution in this thesis indicates some different institutional characteristics for MNEs. Under those conditions, the law should create its own applicable principles to MNEs because the basic principles of company law have failed to regulate MNEs and thus failed to prevent the unjustifiable situation in tort claims. Accordingly, the best way to regulate corporate groups must be generating regulation that determines the basic requirements and principles of corporate groups as new institutions. This law must
create basic principles of corporate groups including liability issues. Moreover, this new regulation must be innovative relying on its own theories rather than borrowing theories from company law.

After determination of the requirement for a single regulation, there should be a discussion whether the law should be standards-based or detailed regulation. The issue simply is whether regulation must be expressed through a number of general standards or a detailed set of legal rules. From the viewpoint of common law systems, the options are either standards-based regulations or detailed regulation. Actually, case law based characteristics of the common law support regulation on principles. In other words, if there is a necessity for regulation it will support standard based regulation rather than rule based regulation. However, from the perspective of the discussion in the previous chapters, the standard based regulation seems more logical and efficient. Thus, it would not be advisable to undertake a detailed regulation aimed at forecasting problems caused by diverse corporate entities in a group. Thus, the need to encompass all general situations requires supporting standard based regulatory approaches.

The principal discussion carried out in this thesis related to managerial structure of companies and also points out more general and standard based regulations. Accordingly, the dynamic characteristics of modern enterprises with a complex horizontal structure might make detailed regulations inefficient. The laws that have very rigid detailed regulations and principles might create unexpected results such as Salomon ruling did in corporate groups' context. Thus, rather than trying to regulate any details based on one single understandings of a corporate groups, the focus should be on creating a regime that is suited to the complexity of groups and thus, flexible in application.

It can be claimed that the Forum Europaeum proposal and the recent EU Action Plan are in favour of standards-based regulation. According to the general policy of the

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54 Irujo, Trends and Realities. (n 53)
55 Irujo, Trends and Realities. (n 53)
Union, during the period of attempts of regulations, the European Union seemed to prefer a corporate group law based on the formulation of major standards, leaving specific aspects relating to the formation and operation of corporate groups to the member states or, where applicable, to self-regulation. However, the other side of the argument claims that exposing groups of companies to different legal requirements or a differentiated extent of liability according to the laws of the individual member states only complicates and endangers the rights of all creditors at the European level. The fear always exists that regulation based on just standards for corporate groups might put regulations in jeopardy and there would be complex and differentiated regulatory systems in every member states for MNEs.

However, at a regional level, the lack of international aspects in company law: sovereign and local characteristics of the law support standard based regulations while leaving the details of rules to national states. On the other hand, one can claim that since MNEs and institutions have very similar characteristics and structures, the regulations should support detailed liability rules being applicable in all jurisdictions. In conclusion, the issue must be considered in accordance with the level of the regulation; there must be standard based regulations if regulations are at regional or international level. However, there must be more detailed regulations if regulatory effort is at national level. In other words, standard and rule based regulations might exist jointly: the efforts to regulate corporate groups must be built considering the different characteristics of legal systems. Therefore, there must be principle-creating regulations at global level: standard based regulation at regional level and rule based regulation at national level so that the conflict of principles of liability will be avoided.

The discussion of standard or rule based regulation reflects another challenge whether establishing regulation as situation or process (static or dynamic regulation). The discussion carried out on this thesis is that the corporate groups are changing and thus they must be regulated with specific concern to this reality. Accordingly, MNEs are under a changing process resulting from basic structural

56 Irujo, Trends and Realities, (n. 53)
principles of capitalist economies and pressure of maximising profits. Thus, regulatory efforts should consider those processes and it should have impact on the future of corporate group law. If lawmakers regulate MNEs as static institutions, the new law regime would be struggling to solve problems the next generation of MNEs will create.

The law systems have already made a mistake by considering companies as standstill institutions and kept the same structure and principles of company law for decades. The laws and principles have been established considering corporate groups as simple structured institution with quite clear separation between parent and subsidiaries and amongst subsidiaries. This mistake of considering corporate groups as simple organisations has resulted in very complex and inefficient legal regime of liability for group of companies. Moreover, considering groups as static institutions is one of the reasons that prevent possible developments since it is very difficult to change legal rules once the rules have been settled. For example, the mistake made while applying limited liability to corporate groups prevents changes of limited liability rules in modern company laws; even in very specific circumstances it requires very detailed discussions and burdensome efforts. Moreover, concentrating on a static situation in law making demolishes the possibility to produce empirical data for alternative regulations. Regulations of corporate groups should thus not focus completely on the principles considering the group as a mere static situation since formation of corporate groups require that all references to different approaches must not be ruled out. Therefore, understanding groups as a process allows us to have necessary flexibility. The difference with the static standards is therefore that the economic and legal processes that lead to such a situation are also included in regulation thus giving it better chance of adoption in economic and legal life. Therefore, the regulatory efforts should focus on the basics of MNEs characteristics and should try to cover many situations including the current structure of the MNEs. It also should consider future developments by aiming to have influence in shaping the future of the MNEs structure.

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57 Irujo, Trends and Realities. (n 53)
The next step in discussions of the future of MNEs tort liability must be search for answer to **how MNEs should be personalised** in law. First, there should be discussion of regulations from the perspective of whether regulations should be based on the concept of groups of companies or a concept of MNE. One of the interesting aspects of the recent attempts in regulatory efforts of corporate groups’ liability is concentration on the concept of corporate groups. This situation creates the problem of separation between a group of companies and MNEs. Right from its most basic principles, corporate group law certainly reveals an institutional concern despite the group’s lack of a corporate personality. Accordingly, groups of companies have attracted some regulatory efforts in national jurisdiction but when attempts are made to extend these regulatory efforts to MNEs, more problems arise because of the jurisdictional limits of the regulations or reluctance of lawmakers to apply the same laws to groups of companies outside of national borders. Moreover, there are number of characteristics and institutional differences between group of companies and MNEs. As a result, these differences between groups of companies and MNEs might affect the outcomes of any legal regulation aiming to create justifiable liability for MNEs since any effort has to consider special characteristic differences of MNEs.

For these reasons, the problem of MNEs’ personality must be clarified. Accordingly, one of the most important arguments in this area is whether MNEs are recognised as international legal personalities or they are still considered a group of independent companies operating together under common management. To be able to discuss the possibility of attributing legal personality to MNEs, one should begin with clarifying the legal situation of groups of companies. No legal system grants legal personality to groups of companies, rather the national laws impose some liabilities and responsibilities on parent companies while maintaining the separate legal personality of member companies. In an application of the situation of a group of companies’ law to MNEs, it is undisputable that MNEs are not recognised as international legal personalities; international law does not grant them a privileged international legal

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58 Irujo, Trends and Realities, (n 53)
personality status. Public international law is only implemented in their regard through state action, so that they continue to be subject only to domestic law of states.

In this discussion, logically, it is not appropriate to change the situation of MNEs personality by attributing an international legal personality status to MNEs, because their direct participation in the process of creating legal norms applicable to them and their access to mechanism for the application of international law could be at the expense of certain values and essential principles of international law, in view of their discretionary function in the economic sphere.\(^{59}\) In other words, the legal world has to consider their huge economic and political influence on the governance of national states and the world economy since granting MNEs with legal personality is like equipping them with most powerful weapons in a war.

Accordingly, under no situation should international law be applied when contracting with MNEs and it is unacceptable that a contract should provide for the application of such law, because it would mean that national law is being disregarded and it accepts the ambition of MNEs to evade state control. In order for MNEs to be held accountable for their actions, it is not necessary to give them an international legal status, because national legislation might contain provisions, which are applicable to all companies under the group, and there are treaties between states to deal with conflicts of laws and enforcement issues. Any means of liability can be imposed on MNEs without considering them as legal persons in international law. In conclusion, either regional law, such as EU law, or domestic laws are capable of imposing liability without further recognition of groups of companies and MNEs as legal persons. The enforcement of laws on groups has already been common practice for tax and group accounting purposes. Therefore, it is very possible to manage similar enforcement in terms of tort liability.

Clarifying legal personality, the next stage of discussion must be models of liability imposed on different personalities (group liability, parent liability, and
subsidiary liability, (Entity v. Enterprises). There have always been some discussions about models of liability on corporate groups. Models for regulations have varied: some pointed to parent companies to be held liable for subsidiary's tort, and some support the subsidiary liability together with some obligations on the parent. The broadest one was an attempt to create an enterprise theory under which all the assets of the group are combined. The recent attempts usually concentrate on aggregation of assets in corporate groups since the corporations’ law already requires this to be done for accounting purposes. This would seem to provide creditors and other interested parties with information that would allow such persons to make an informed assessment of the creditworthiness of a related group of companies.⁶⁰

Liability for parent companies, finding its justification for allowing creditors to reach the assets of parent corporations, does not create unlimited liability for any MNE. Thus the benefits of diversification, liquidity, and monitoring by the capital market are unaffected. Moreover, the moral-hazard problem is probably greater in parent-subsidiary situations because subsidiaries have less incentive to insure creditor protection.⁶¹ However, liability aiming at parent companies have many weak points since they can escape liability by proving their non-involvement in control of the subsidiary since the liability attributed for their control over subsidiaries. Thus, the concentration on parent company for liability does not create solutions under the current organisational structure, which is always more complicated than the one described or presumed by the court or lawmakers.

In case of the group liability concept, this perception is not very different from parent corporation liability since in cases or statutes the liability is mostly directed to the parent and parent mostly has mere duties imposed on the limit of separation between subsidiary and the parent. Therefore, interestingly, any term of group liability used in

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⁶² Easterbrook and Fischel, the Economic Structure p. 57 (n 21)
statutes or case law or even by scholars do not exactly mean group liability but rather they refer to parent liability.

This lack of group liability concept or failure to distinguish differences between parent liability and group liability has affected the emergence of the concept of enterprise entity doctrine. The doctrine differs from existing concepts of group liability in that it replaces an approach based on exceptions to the otherwise unbreakable corporate separation between the parent and subsidiary (whether through the lifting of the corporate veil or through specialized group liability laws) with one that presumes parent company liability from the fact of economic integration between itself and the subsidiary. This recognises the corporate group as a distinct form of business association, thereby opening the way for the evaluation of a specialized legal regime going beyond the model of the single unit limited liability joint stock company. Thus, the concepts of enterprise liability may offer a solution, especially in the case of mass torts, but its extent and limitations remain to be explored. The closest example to enterprise theory can be found in the Amoco Cadiz case but as already mentioned at case was exceptional and never created a better doctrine in the common law case law. Therefore, a broader conception of groups as an enterprise has not prevented criticism of the enterprise theory. For example, an enterprise entity approach has been criticised for being too hierarchical since it aims again basically at parents for imposing liability ignoring the current developments in corporate group structure. In this sense the enterprise theory does not offer a practical radical solution to corporate group liability but it offers a better ground for veil lifting. The examination of enterprise theory proves as well that corporate groups have been considered vertical organisations and thus the corporate veil is always considered as clearly existing and thus should be lifted since separation amongst the entities is still the basic of the theory. Accordingly, liability could be avoided by proving there is no jeopardizing corporate veil between entities.

63 Nygh. The Liability. (n 11)
64 Muchlinki, Multinational Enterprises. p. 328 (n 62)
Thus, enterprise liability on those conditions turn to be veil-piercing law in corporate groups with a more appealing name.

The major problem underlying the evaluation of an enterprise entity approach to group liability rests in identifying the existence of such a business association. This requires the use of economic theories of corporate integration so as to develop a clearer concept of the group under which the parent can be said to control its subsidiaries for the purpose of liability. Thus, the outcome of any claim based on the enterprise theory depends on an interpretation of evidence that reveals a more complex structure than the theory suggests. Therefore, the enterprise theory has not developed in connection with reality but developed on the same belief of the parent and subsidiary divisions and belief of the parent’s control over subsidiaries. It still contains many obstacles since it requires examination of structure of the enterprise to prove that the enterprise is operating in integrated ways.

Accordingly, on the issue of comparison of entity and enterprise theories in group liability concept, one will see that the developments of enterprise approach or parent liability approach through veil-piercing judgment is not really a huge departure from Salomon’s entity law principles. The separation between entities and the liability is based not on ownership or not derived from the economic realities but it is developed from tort law under which control and involvement of the parent is searched for to impose liability for their acts.

In order to solve the deadlock created by these theories, the discussion must concentrate on why corporate groups must be liable (liability based on ownership and business organisation or control: demise of control theory). It is inevitable that in any case of liability regime there must be a basic justification: in order to create the theory for the future of liability issues relating to MNEs, the legal systems should base their justification on certain theories. Thus principles for liability are very important question to consider on the aim to achieve justifiable regulation for MNEs torts. On the earlier
and existing regulations and application of liability in corporate groups, the emphasis has been on the control theory, under which there is a search for excessive control of one entity over another in order to impose liability to controller. On the absence of this excessive control, the controller entity might escape liability even though it owns all the shares in the controlled entity. In these circumstances, there is an unfair situation that the owner of the shares might escape liability even though they collect all the benefits of subsidiary’s success.

The level of required control or practical approaches to prove the control has been varied in the past in regulation and case law. In the first introduction of control theory, there was liability only in clear fraudulent use of control over a subsidiary. When this was not enough, the required level of control was reduced or burden of proof was shifted from claimants to the company itself (supposed control) but there has been no shift from the requirements of control in corporate groups to make one entity liable for others acts. However as it was already mentioned in qualified de-facto groups in German law or assumed control in EU competition cases, even the presumption of control is always rebuttable. Moreover, under the complex horizontal structure of MNEs, it is not difficult for a parent company to submit conclusive evidence of proof that the subsidiary was independent and was making its own decision since the modern structure of MNEs suggests that subsidiaries are not only becoming more independent in their own decision-making but also becoming more dependant on principles of decision making. Accordingly, there is a situation under which a day-to-day involvement in subsidiaries decision-making is not common practice but there is a consistent application of cultural control in MNEs. Therefore, establishing liability on the basis of control is very difficult and more likely to be effective in single member companies and small-scale domestic corporate groups.

These changing characteristics of decision-making and control with horizontal structure should force lawmakers to think of better functioning theories for liability in

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MNEs’ tort. In the failure of excessive control theory, we should divert our attention to liability based on **principles of ownership and business organisation**. These principles should be considered together with social, economic and managerial structure of the MNEs.

Of course, broad examination of ownership theory might lead us to a complete removal of limited liability. However, bringing these theories with the justification theories for existence of limited liability and differentiation between individual shareholders and company shareholders, removal of limited liability for corporate shareholders might be justified. As a result, it will be more efficient to create liability on corporate groups not by their control over their subsidiaries but common ownership of the enterprise as a group through separate legal entities. By doing this, the burden of proof in control theory will be removed so that strict requirements of factual examination of the relationship between the parent and the subsidiary will be eliminated. Together with this positive development, the law should consider every company under the group as part of business organisation and thus liable for any tort other entities of the business organisation has committed. The system of liability based on ownership and business organisation will be based on removal of limited liability for purpose of creating effective liability for tort victims similar to allowing corporate groups to apply group relief for the losses made by subsidiaries: the ECJ allowed *Marks & Spencer Plc* as parent company to reduce the loss made by its European subsidiaries from its profits. Applying the same logic to tort creditors, parent companies or other subsidiary companies under a group should be held liable for the tort actions of any subsidiary.

Accordingly, any country that a subsidiary of MNEs is established in will have jurisdiction over all components of MNEs through the subsidiary established in that country. This can in a sense create a **subsidiary-to-subsidiary liability**, which means liability for a subsidiaries tort not only on parent but also on other subsidiaries in a group. Basically, there will be group liability for the torts committed by subsidiaries but

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66 ECJ Grand Chamber: *Marks & Spencer plc v David Halsey* (Her Majesty's Inspector of Taxes). (C-446/03)
since the group has no legal personality, this liability is imposed on legal personalities in the groups. Accordingly, the liability can be imposed on parent or other subsidiaries.

As a result, efforts must concentrate on a comprehensive liability regime that is built by taking into consideration the problems in historical developments in the area and taking modern interdisciplinary realities of MNEs into account. Therefore, in principle, imposing liability on business organisation principles together with ownership theory while considering managerial structure of the modern enterprise (liability on entities without necessarily involving the parent) is attractive. 67

The new liability regimes must be based on creative theories that are wide enough to solve current and future problems. Therefore, considering MNEs as non-veil enterprises in tort liability is very appealing. For the better and most efficient liability regimes, the corporate groups should be considered as an enterprise with no veil amongst entities; for the issues relating to liability and the corporate veil must be kept in the extent of necessity for practical economical functions. In this way there will be a balance between economic requirements of modern global capitalism and requirements of justice. The victims of MNEs torts must be able choose the entity against which they want to bring their cases. The judgment of the tort must be made on behalf of the business organisation so the organisation must be held liable through the personality of the entity that the case has been brought against. In this system, the liability of parent or other entities will not just cover compensation but there will be direct enterprise liability for the tort action. Attributing direct liability to enterprise itself by making entities under an enterprise to face civil liability action will also remove jurisdictional barriers. The proposed liability regime is indicated by the figure below.

Figure 9: Liability Based On Organisational Structure

Victims

Liability claims

Tort

Sub.

Parent

Sub.

Sub.

Sub.

Sub.
CHAPTER VI: CONCLUSION

Finding solutions to MNEs tort liability problems will start by questioning social-economic roles of MNEs in modern capital industries and will lead to the question how ready modern law regimes are to change some basics of modern capital economic principles. In other words, the fundamental issue in the regulation of corporate groups and MNEs is to which level market economies are willing and able to move beyond the traditional models of the company to one contemporary justified model of MNEs. Thus, implementation of broader liability is as well a problem of political choice as legal problem.

Consequently political obstacles must be overcome by creating alternative movements to current standings. The current thesis deals with political issues by illustrating the injustice created by the current system of liability even though none of them yet have been able to create a notable influence on a political stance on liability issues. The author believes that the issues will come to the political agenda eventually. It is predicted that public pressure on politicians will reach to a level to force them to introduce fair liability regime for MNEs. Accordingly, the proposed solutions to problem of MNEs tort liability should be comprehensive enough to overcome not only today’s practical challenges but also create a future for the MNEs liability regulation. The present thesis indicates that the problems are not impossible to solve and alternative regimes are readily available with some compromise. The current groups of companies’ regimes ignore most important characteristics of MNEs, for this reason they mostly fail to satisfy requirements of justice in social justice theory. However, there is no such a thing as creating a new legal system from nothing. Thus, the new legal structure must be created by examining past efforts, either successful or unsuccessful, with the aim of improving the ideas or developing better principles. This thesis, in this sense, has indicated suggestions for alternative solutions.
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