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Assumption of Direct Responsibility for a Subsidiary's Liabilities – Is the Corporate Limited Liability Veil in Tatters?

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In the landmark decision of Chandler v Cape plc (2012) EWCA Civ 525 *the Court of Appeal for England and Wales has upheld a High Court decision that a parent company owed a direct duty of care towards an employee of one of its subsidiaries to ensure a safe system of work. This case has expanded the potential liabilities of parent companies for their subsidiaries and has far reaching implications for group companies, operating in the UK or overseas.*

The Claimant had been employed by Cape Building Products Ltd (Cape Products), a wholly owned subsidiary of Cape plc for 18 months between 1959 and 1962. Cape Products manufactured asbestos products. In 2007, the Claimant discovered that he had contracted asbestosis as a result of negligent exposure to asbestos dust during his short period of employment with Cape Products over 50 years ago. By 2007, Cape Products no longer existed and its remaining employee liability insurance policies excluded asbestosis. Therefore the Claimant did not seek to have the dissolution of Cape Products set aside to enforce the policies. The Claimant instead brought a negligence claim against Cape plc alleging that it owed and had breached a duty of care towards him.

The High Court Decision

In 2011, the High Court ruled that there was no issue that the system of work at Cape Products was unsafe. It went on to hold that Cape Products' parent company Cape plc owed and had breached a direct duty of care to the Claimant, based on the English common law. The Court applied a three-stage test of assumption of responsibility: 1) the damage was foreseeable; 2) there was sufficient proximity between the Claimant and Cape plc; 3) and it was fair, just and reasonable for a duty of care to exist. The key findings supporting this decision were that Cape Products had acquired its asbestos business from Cape plc; Cape plc controlled some aspects of Cape Products' business, Cape Plc controlled the health and safety policies and practice across the group and had assumed responsibility for ensuring that its own employees and those of its subsidiaries were not exposed to harm from the exposure of asbestos and Cape plc had appointed a group medical advisers to advise on health and safety issues arising from asbestos. The High Court also found that Cape plc had actual working knowledge of the Claimant's working conditions and was aware of the risks presented by exposure to asbestos.

The Judgment on Appeal

The Court of Appeal agreed with the High Court's findings and held that in appropriate circumstances the parent company's actions may give rise to parent company liability for the health and safety of its subsidiary's employees. Those circumstances include where: 1) the business of the parent and subsidiary were in a relevant respect the same; 2) the parent had, or ought to have had, superior knowledge on some relevant aspects of health and safety in the particular industry; 3) the subsidiary's system of work was unsafe as the parent company knew, or ought to have known; and 4) the parent had known or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employee's protection.

One critical finding by the Court of Appeal is that for the purposes of proving point (4) above the court will look at the relationship between the two companies more widely and it is not necessary to show that the parent company intervened in health and safety matters. It may be sufficient if the parent company has a practice of intervening in the trading operations of its subsidiaries even if the interventions are unrelated to health and safety matters. This is substantially broader than the High Court's findings and appears to erect a very low threshold for inter-company liability.

Implications for the "Corporate Veil"

There are two central and long-recognised principles of English common law concerning most English companies. Firstly, that a company is a separate and independent legal person distinct from its members (the ‘corporate veil') and, secondly, that the liability of its members is limited. The concept of the corporate veil derives from Lord Macnaghten's observation in *Salomon v A Salomon & Co Ltd.*, [1897] AC 22, that a 'company is at law a different person altogether from the subscribers to the memorandum'. This concept of separate legal entities has been found to apply equally within groups of companies. In *Adams v Cape Industries plc*, [1990] Ch. 433, Lord Justice Slade described subsidiary companies as being 'separate legal entities with all the rights and liabilities which would normally attach to separate legal entities' despite 'in one sense [being] creatures of their parent companies.'

Over time, the concept of the corporate veil has been challenged but ultimately upheld, with piercing the corporate veil being limited to three possible circumstances, namely, sham or façade, agency, and where statute requires. However, this decision appears to be the latest in a series of recent decisions once again challenging the basis on which the veil remains in place.

In this decision, the Court of Appeal "emphatically rejected" any suggestion that this case impacts on the concept of piercing the corporate veil, stating that the imposition or assumption of responsibility was related to the relationship between a parent and its subsidiary. Instead the sole issue was whether or not the parent had taken on a direct duty by way of its actions. Nevertheless, the decision does result in a parent company's liability for a subsidiary's activities and whether that amounts to a piercing of the corporate veil or not, the result is much the same in practical terms.

Two other recent and divergent High Court judgments handed down in the last year have caused renewed interest in the English court's ability and willingness to pierce the veil. In *Antonio Gramsci Shipping Corp v Stepanovs [2011] EWHC 333 (Comm)*, Mr. Justice Burton found a good arguable case that the veil of incorporation should be pierced in order to make liable under various contracts the ultimate beneficial owners of companies which he considered to have been formed for the perpetuation of fraud. In reaching this decision, he observed that there was ‘no good reason of principle or jurisprudence why the victim cannot enforce the agreement against both the puppet company and the puppeteer who, all the time, was pulling the strings. ... I accept ... that the puppeteer can be made liable, as a party to the contract, but that as a matter of public policy he cannot enforce the contract' (at paras. [26] and [27]). In contrast, Mr. Justice Arnold in *VTB Capital plc v Nutritek International Corp [2011] EWHC 3107 (Ch)* declined to follow much of

Burton J.'s reasoning, observing that the decision was 'not so much a decision to pierce the corporate veil as a decision to ignore privity of contract ... Neither in Gilford v Horne [1933] Ch 935 nor in *Jones v Lipman* [1962] 1 WLR 832 were damages awarded against the puppet for breach of the puppeteer's contract. Rather, equitable relief was granted against the puppet to stop the puppeteer evading his own contractual liability. Thus the puppet was not treated as being party to the puppeteer's contract' (para. [101]).

These decisions have provoked renewed debate about the proper scope of the corporate veil concept in English law. Despite the Court of Appeal's disclaimer in the *Chandler* judgment, it appears the judge-made parameters of this common law doctrine may be in process of being altered. This may have far-reaching implications for those claiming redress against others who seek to protect themselves behind what was heretofore thought to be a relatively impregnable veil of incorporation. It also will cause shareholders and directors to reconsider the reliability of the veil and the use of corporate 'blockers'. On an operational level, directors will also need to ensure that there is clear delineation between the activities and decisions of a parent and the operations of a subsidiary.

Implications for Employer Liabilities

In any event, the *Chandler* decision should be noted by group companies, particularly those who may have employees with latent personal injury claims that may not be discovered for a number of years and where the directly employing subsidiary no longer exists, is unable to meet a claim for damages, or has failed to have adequate employee liability insurance cover in place, by recognising a possible alternative cause of action against the parent company. However, the Court of Appeal stressed that the duty of care from the parent company to the employee of one of its subsidiaries does not arise automatically by operation of law and therefore each case will need to be analysed carefully on its own factual merit in order to establish whether the parent company has assumed direct responsibility for the employees of its subsidiary. The lesson may be that just as equally the corporate veil itself may not arise automatically either.

Finally, as recently noted in our articles on the English law approach to insurance coverage trigger for asbestos injuries, both in the employee liability context and for third party liability[1], the ability of an employee of a subsidiary now to bring direct claim against a parent company raises interesting and as yet unresolved questions as to whether the parent's insurance cover can and will respond to such claims. A careful eye will need to be kept on this and group parent companies would be well advised to review both their present and historic operating procedures as well as terms of insurance cover.

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[1] English Law Reinsurance Contracts May Not Cover Asbestos or Other U.S. Liabilities, Raymond L. Sweigart; UK Supreme Court Pulls Trigger on Asbestos Liability Insurance, Raymond L. Sweigart

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