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Corporate Social Responsibility: A New Era of Transnational Corporate Liability for Human Rights Violations?

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Can a Canadian parent company with a subsidiary operating in a foreign jurisdiction be liable for human rights violations in the foreign jurisdiction that occur at the level of the subsidiary? In a recent decision,[1] an Ontario court has allowed this issue to proceed to trial in three related actions, rejecting arguments by the defendants that the claims brought by the plaintiffs, all of whom are residents of the foreign jurisdiction, disclose no reasonable cause of action.[2]

While the recent Ontario court decision involved a Canadian mining company, the outcome has implications for other industries. Whatever the outcome at trial where issues of liability will ultimately be determined, one thing is clear: International public expectations are changing, and directors and officers of Canadian companies need to be aware of the potential risk of claims by foreign plaintiffs seeking redress for alleged harm committed beyond Canada's borders.

This article provides an update of the key issues that arise from the Ontario court decision, and highlights key takeaways for Canadian parent companies with foreign subsidiaries.

Key issues arising from current proceedings

Lifting the corporate veil – liability under agency principles

It is a long-standing principle of Canadian corporate law that companies are distinct legal entities, and parent companies are not liable for the acts or omissions of their subsidiaries. There are certain limited exceptions to this rule, including instances where a subsidiary is acting as an "authorized agent" of its parent.[3] In such instances, a court may "lift the corporate veil"

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and hold the parent liable for the acts or omissions of the subsidiary.

In the recent Ontario decision, the court found that, in one of the actions, the plaintiffs had sufficiently pleaded that an agency relationship existed between the parent and its foreign subsidiary at the material times. As a result, the court concluded that the question of whether an agency relationship existed between the parent and its subsidiary is not "patently ridiculous or incapable of proof," and allowed this issue to proceed to trial.

Direct liability in negligence – a novel duty of care

There is currently no established duty of care owed by a parent company to ensure that the operations of its foreign subsidiaries are conducted so as to protect the residents of the communities with whom the subsidiary interacts. The plaintiffs argued that, under long-standing principles of tort law, if a duty of care can be established, a parent and its subsidiary can be found jointly and severally liable for negligence if the direct actions of each result in damage.[4]

The Ontario court found that the plaintiffs had pleaded all the material elements required to support the establishment of a novel duty of care. Accordingly, the court allowed the issue of whether a novel duty of care should be recognized in the circumstances of the actions to proceed to trial.

It is important to note that the foreign plaintiffs in the three actions do not claim that the parent company is indirectly responsible for the conduct of the security personnel that is alleged to have caused the harm, rather that the parent company is directly responsible for having failed to prevent the harm. It is also important to note that once a duty of care is established for a category of cases, it becomes an established duty of care for future cases. This raises the importance of the three actions that have been allowed to proceed to trial.

Under Canadian tort law, there is a three-fold test for establishing a novel duty of care:[5]

- **Foreseeability of harm:** First, the harm complained of must be a reasonably foreseeable consequence of the alleged breach. The relevant question is whether the defendant knew or ought to have known about the potential for "general harm" (not "its manner of incidence").

  In one of the three actions, the facts alleged by the foreign plaintiffs against the two Canadian defendants included allegations that they knew or ought to have known that violence is frequently used by security personnel to force evictions of local communities in the foreign jurisdiction, and knew about past violence by security personnel to force evictions of local communities in the foreign jurisdiction, the heightened risk that more extreme forms of violence would be used during the eviction in remote communities, the deficiencies of the local justice system, and the high incidence of violent crime in the foreign jurisdiction.

  In the other two actions, the foreign plaintiffs alleged that the Canadian defendants had authorized the use of force in response to peaceful opposition and controlled and directed security personnel, and that the harms were a reasonably foreseeable consequence because the Canadian defendants' managers and executives were advised of rising tensions, knew that violence had been used at previous forced evictions, knew that the chief of security had been credibly accused of serious and criminal acts (including issuing death threats), knew that security personnel were inadequately trained and in possession of illegal firearms, and knew of deficiencies of the local justice system.

  The Ontario court found that if these and other alleged facts were proven at trial, they could establish that the harm complained of was a reasonably foreseeable consequence of the conduct of the Canadian defendants.

- **Proximity:** Secondly, there must be sufficient proximity between the foreign plaintiffs and the defendant such that, in conducting its affairs, the defendant had an obligation to be mindful of the plaintiffs' interests.[6]

The factors that could satisfy the test for proximity include (a) a close causal connection, (b) the parties' expectations, and (c) any assumed or imposed obligations. Alleged facts in support of a proximate relationship put forward by the foreign plaintiffs included statements by the parent's senior management concerning discussions with local residents to seek solutions and develop trusting relationships, various promises made by the parent to respect human rights "in the best possible manner," and public statements by the company that it had adopted certain internationally recognized standards (of which more later).

The Ontario court found that the pleadings disclosed "a sufficient basis to suggest that a relationship of proximity between the plaintiffs and defendants exists, such that it would not be unjust or unfair to impose a duty of care on the [parent company]." It is important to note, however, that the court did not find that a duty of care has been found to exist, and simply concluded that, "It is not plain and obvious that no duty of care can be recognized. A prima facie duty of care may be found to exist ... [at trial]." (Emphasis added.)

- Policy considerations: Once the first two parts of the test are satisfied, a novel duty of care is established on a prima facie basis. As part of its analysis, the court must then determine whether there are any policy reasons that negate or otherwise restrict the recognition of a prima facie duty of care.

In the current proceedings, both the plaintiffs and the defendants put forward policy reasons to support their position as to whether the court should recognize a new duty of care in the circumstances.

The defendants argued, among other things, that a private member's bill introduced to require Canadian extractive companies to meet environmental and human rights standards was defeated (Bill C-300). The defendants also argued that "recognizing a duty would pre-empt the efforts of the federal government over the past seven years to work with Canada's mining sector to implement corporate social responsibility principles" and that "recognizing a duty risks exposing any Canadian company with a foreign subsidiary to a myriad of claims, many of which will likely be meritless."

In response, the foreign plaintiffs took the position that policy considerations favour the finding of a duty of care for a number of reasons, including the fact that the Government of Canada has endorsed international standards of conduct in relation to human rights for Canadian businesses operating abroad, and that establishing a duty of care in this area would support initiatives by the Government of Canada.

The Ontario court found that there were clearly competing policy considerations in recognizing a duty of care in the circumstances, and that it is not plain and obvious that a prima facie duty of care would be negated for policy reasons.

Having concluded that the pleadings could satisfy the test for reasonable foreseeability and proximity, and that it was not plain and obvious that policy considerations would negate the finding of a duty of care in the circumstances, the court rejected the argument that the claim should be struck out as disclosing no reasonable cause of action for a novel claim of negligence against the defendants.

Questions and key takeaways

Canadian parent companies with foreign subsidiaries face some difficult policy issues that arise from the recent Ontario court decision, and others that could arise if the foreign plaintiffs are ultimately successful at trial. For example:

- **Agency relationship:** If the Canadian parent company is ultimately found to be indirectly liable for the actions of its subsidiary under the theory that the subsidiary was acting as the "authorized agent" of the parent, it will be important to consider the basis for the finding of "agency." In particular, it will be necessary to consider whether the basis for the finding of "agency" is an erosion of the long-standing, foundational principle of corporate separateness, or whether the factual findings in respect of the actions of the parent and subsidiary fit easily into the traditional grounds for a finding of agency. The result could have implications for what parent companies should do to mitigate liability through their corporate governance structures. For example, a distinction must be made between, on the one hand, actions that demonstrate a principal-agent relationship between a parent company and its subsidiary,[7] as compared to, on the other hand, activities in relation to subsidiaries that are part of an appropriate governance structure and may be necessary for the parent to comply with securities and other legislation, such as the preparation of consolidated financial statements or the setting of general company policy.[8]

  Whatever the result, companies will have to consider issues of reputational risk and enterprise value risk that all too frequently attend a company faced with allegations of human rights violations.

- **Novel duty of care and the role of international law:** Significantly, the Ontario court granted intervener status to Amnesty International, permitting it to give evidence on international law and international norms in the area of human rights. Voluntary codes of conduct cited as evidence that a novel duty of care may exist in circumstances where a parent company's subsidiary is alleged to have been involved in human rights abuses included the *Voluntary Principles on Security and Human Rights*, the OECD *Guidelines for Multinational Enterprises*, the UN's *Protect, Respect and Remedy Framework for Business and Human Rights,* and the International Standards Organization's involvement in corporate social responsibility (e.g., ISO 26000). Amnesty International submitted that, "The existence of these international norms and standards of conduct demonstrate the recognition by companies in the extractive industries of the risks of security forces, both public and private, violating human rights and otherwise causing injury to members of local communities in high risk areas."

  It is also noteworthy that the Ontario court cited the parent company's alleged public statements to the effect that it had implemented the internationally recognized *Voluntary Principles on Security and Human Rights* as a factor to be taken into account in determining the proximity part of the test for establishing a novel duty of care.

  If this factor continues to be applied, the adoption of international codes of conduct and best practices in managing human rights could impact the legal risks facing a Canadian parent company in its foreign operations. Such a result could undermine the overarching goals of these currently voluntary standards for promoting human rights best practices globally. Further, it begs the question whether any duty of care emerging from international standards could be construed as a duty applying to an industry as a whole, making it irrelevant whether the individual company has voluntarily adopted the standard. In the meantime, Canadian

companies need to exercise caution when implementing written policies and making public statements concerning their corporate social responsibility practices, including in the area of human rights.[9]

- **Common law versus statutory liability:** The Government of Canada has made a clear choice not to implement a prescriptive approach to enforcing international human rights standards (at least as yet). This might be compared to the path chosen by the Government of Canada to legislate against the bribery of foreign public officials under the *Corruption of Foreign Public Officials Act* (Canada), which concerns a different area of corporate social responsibility and which was originally implemented to ratify the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. From a policy perspective, establishing a novel duty of care at common law premised upon, among other things, a myriad of best practices articulated by international and transnational organizations, could create a level of uncertainty for Canadian parent companies without clear guidelines as to whether, for example, the company has an absolute obligation to prevent harm, or whether taking adequate steps proportionate to the risk to prevent harm mitigates against such liability.

Canadian companies need to exercise caution when implementing written policies and making public statements concerning their corporate social responsibility practices, including in the area of human rights.

- **Due diligence:** It is noteworthy that certain of the conduct alleged by the foreign plaintiffs occurred before the Canadian parent company acquired the foreign subsidiary. This highlights the importance for Canadian companies to be mindful of the need for due diligence on human rights issues when acquiring companies, and the need to deal with the risk of litigation through appropriate contractual provisions. **CB**

The global business ethics team at Norton Rose Fulbright can advise on international guidelines and principles respecting human rights, the conduct of human rights due diligence investigations, and the type of training required to address the various types of risk in multiple foreign jurisdictions and emerging markets.

NOTES

1 *Angelica Choc; German Chub Choc; Caal et al. v. Hudbay Minerals, Inc. et al.*, 2013 ONSC 998 *http://canlii.ca/en/on/onsc/doc/2013/2013onsc998/2013onsc998.pdf; Choc v. Hudbay Minerals Inc.*, 2013 ONSC 1414 (July 22, 2013) (Ontario Superior Court of Justice) *www.chocversushudbay.com/wp-content/uploads/2010/10/Judgment-July-22-2013-Hudbays-motion-to-strike.pdf.*

2 In the event that the motions to strike were successful, the foreign defendant also brought a motion to stay the actions on the basis that the Ontario court had no jurisdiction vis-à-vis the foreign defendant. Given that the motions to strike were unsuccessful, the court did not make any determination on the issue of jurisdiction.

3 Canadian courts will also pierce the corporate veil where the company is completely dominated and controlled, and being used as a shield for fraudulent or improper conduct. The court concluded that, in the current proceedings, the pleadings were not sufficient to satisfy this exception to the rule of separate legal personality.

4 The arguments put forward by the foreign plaintiffs are framed under long-standing common law principles, as one would expect in the absence of express contractual or statutory provisions.

5 The Ontario court applied the test originally set out by the House of Lords in *Anns v. Merton London Borough Council* [1978] A.C. 728 and adopted by the Supreme Court of Canada in *Kamloops (City of) v. Nielson* [1984] 2 S.C.R. 2.

6 The Ontario court applied the test originally set out by the Supreme Court of Canada in *Hercules Managements Ltd. v. Ernst & Young* [1997] 2 S,C,R, 165.

7 Or that the parent is exercising complete domination and control over the subsidiary for a fraudulent or improper purpose.

8 We also note that the Ontario Securities Commission has weighed in on corporate governance practices for Canadian parent companies of foreign subsidiaries in emerging markets. See, for example, OSC Staff Notice 51-720 – *Issuer Guide for Companies Operating in Emerging Markets* released November 9, 2012, by the Ontario Securities Commission and our firm bulletin, "Securities in brief – OSC provides guidance for emerging market issuers."

9 As noted by the Ontario court: "[The] fact that the defendants made public statements that [they] were doing something does not necessarily mean that the parent company was actually doing it. The spokesperson may have been speaking in general terms and it may have, in fact, been the subsidiary taking the action."