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Multinational Enterprise Parent Liability: Efficient Legal Regimes in a World Market Environment

Karl Hofstetter*

The understanding of lawyers as to the characteristics of the MNE [multinational enterprise] is often unsophisticated and erroneous, for there has been no merger between law and economics.¹

I. Introduction: The Bhopal Case as an Example

The topic of multinational enterprise (MNE) parent liability emerges if the assets of a MNE subsidiary in a host country are insufficient to satisfy all creditor claims. It raises the question of parent company responsibility for the outstanding liabilities or debts of its subsidiary. This issue stood at the core of the Bhopal case.

The Bhopal case arose out of a chemical catastrophe at a Union Carbide subsidiary plant in Bhopal, India, in 1984. The survivors of the Bhopal disaster and the successors to more than 3,000 deceased alleged claims of $3.3 billion (U.S.) against Union Carbide. Union Carbide’s Indian subsidiary had assets of less than $100 million (U.S.).² Consequently, plaintiffs brought suit against both the Indian subsidiary and the U.S. parent of Union Carbide. The trial court dismissed the action against the parent company in the United States based on the doctrine of forum non conveniens.³ The trial continued in India and was recently settled for the sum of $470 million (U.S.).⁴

The plaintiffs’ complaint in the United States set forth a theory

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of "multinational enterprise liability." It called for joint liability of all affiliates of "monolithic" MNEs for damages arising out of ultrahazardous activities. The Indian courts, however, which finally handled the case, approached the matter based on more conventional Indian law. In an intermediate judgment, the Indian High Court of Madhya Pradesh held the parent company tentatively liable for $190 million (U.S.) based on the doctrine of piercing the corporate veil. The court used this theory because of the perceived control by Union Carbide Corporation over the composition of the board of directors and the management of its Indian subsidiary. Had a final judgment been rendered by the Indian courts against the parent of Union Carbide, the question of its enforcement in the United States would almost certainly have become a hotly contested issue.

The Bhopal case demonstrated the various facets of MNE parent liability. It revealed the level of emotions and the number of issues associated with the problem of MNE parent liability. It stirred questions about appropriate jurisdiction, choice of law, enforcement of foreign judgments, and, most of all, proper substantive parent liability standards.

In this Article I approach the MNE parent liability topic, exemplified by the Bhopal case, from an efficiency perspective. I show that measuring MNE liability problems with the yardstick of International Social Efficiency (ISE) is appropriate and allows for coherent

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5 Count one of the Complaint by the Union of India against Union Carbide Corp., filed with the United States District Court, S.D.N.Y., April 8, 1985, 85 Civ. 2696.
6 Id.
7 Order of Judge Deo, Dist. Judge of Bhopal, Dec. 17, 1987, aff'd and modified, High Court of Madhya Pradesh, Apr. 4, 1988, Civil Revision 26/88. The order was appealed to the Indian Supreme Court, where the settlement occurred. See N.Y. Times, Jan. 28, 1985, § A, at 1, col. 1.
8 See Item 14 of the High Court Judgment. The court did not consider dispositive the fact that Union Carbide Corporation owned only 50.9% of the stock of its Indian subsidiary. See also U.S. Company Said to Have Had Control in Bhopal, N.Y. Times, Jan. 28, 1985, § A, at 7, col. 1.
normative conclusions about the entire subject. I argue that limited liability for subsidiary corporations is a second best solution to internalize political risks that are more efficiently borne by host country societies than by MNEs. However, I also point out that there are three categories of efficient exceptions to the limited liability of subsidiary corporations, and that they have already started to evolve in various forms. I make an attempt to integrate choice of law and procedural law into the efficiency model for MNE parent liability law. I posit that host country law and host country courts are basically the most efficient choices with regard to the liability control of MNE host country activities. But home country checks on host country legislators and courts may efficiently supplement this scheme. In my conclusion, I stress that the efficiency analysis of MNE liability law reveals the contractual nature of MNE parent liability regimes in host countries, and that their unilateral change by actors such as host country courts will not and should not be free of charge if this amounts to an inefficient "breach of contract" by the host country vis-a-vis the MNE.

II. International Social Efficiency and the Formation of Multinational Enterprise Liability Regimes

For purposes of discussing parent liability arrangements, the MNE can be defined as consisting of a parent company in one country, the home country, and a subsidiary company in another country, the host country. The parent-subsidiary structure has obvious efficiency advantages over alternatives such as licensing, trade, subcontracting, or portfolio investments. The replacement of market relationships by hierarchy can save significant transaction costs. In particular, group integration helps internalize the positive externalities stemming from the exchange of intangible assets in opportunistic international markets. The MNE structure has, therefore, been a most proper fit for the international transfer of privately owned capital and technology.

As a result, the MNE has assumed an increasingly crucial role in world economic affairs. It serves as the major vehicle for the effi-


\[14 \text{See R. Caves, Multinational Enterprise and Economic Analysis 3-5 (1982); N. Hood \\& S. Young, The Economics of Multinational Enterprise 56 (1979).}

cient movement of information and expertise, for example, along changing product cycles. It thereby contributes to the exploitation of potential "world cosmopolitan gains"17 comparable to international trade. The consensus regarding the efficiency of international trade has lead to the establishment of an international legal framework through the GATT.18 No comparable body of international law for direct investment exists.19 But foreign direct investment and international trade are partially mutual substitutes in that they both carry a potential for the promotion of efficient world production. Hence, they can both be explained as functions of International Social Efficiency (ISE).20

The idea of ISE has helped in formulating the concept of “optimal tariffs” in the area of international trade.21 In much the same way ISE can be expected to lend itself towards the development of a

17 World cosmopolitan gains are utility increases through world production as seen from the perspective of the world as a whole. See P. Lindert & C. Kindleberger, INTERNATIONAL ECONOMICS 448 (7th ed. 1982).
19 Numerous bilateral investment treaties, for example, the International Convention on the Settlement of Investment Disputes (ICSID), supplemented by a recent Multilateral Investment Guarannty Agreement (MIGA), and various guidelines for MNE by the OECD and the ILO, build a rather fragmented international law structure for international direct investment. It is noteworthy, however, that investment issues, like trade related investment measures (TRIMs), are now for the first time also a subject at the ongoing GATT negotiations in the Uruguay Round. Whether this marks the beginning of a development towards a “GATT for Investment” remains to be seen.
20 See infra note 30.
21 Lindert & Kindleberger, supra note 17, at 468-69.
concept of "optimal MNE liability regimes" in the area of international direct investment.

A. The Positive Role of International Social Efficiency in the Formation of Multinational Enterprise Liability Regimes

MNE investment arrangements are made in a world market environment. On one side MNEs and home countries are looking for a maximum share in the returns on MNE host country investments. Their rational objectives are profit maximization and risk limitation. On the other side of the transaction host countries and their constituents are also striving for maximal shares in the value created by MNE host country investments. They likewise seek a minimization of their own risk exposure.

Specifically, opportunities and risks associated with MNE investments in host countries are allocated through four principal relationships. These relationships are between: the MNE and its home country; the MNE and the host country; the MNE and its host country stakeholders (creditors); and the home and host countries directly.

Liability regimes are an important component of the risk arrangements for MNE activities in host countries. They are first and foremost set between the MNE and the official host country. A key ingredient of the host country offer to MNE investors is the host country's liability law. Liability standards applicable to the MNE can be negotiated explicitly, but they are more likely to be accepted by the MNE as a contract of adhesion. In either case, rational MNE investors will account for host country liability regimes as an expected cost factor when making their investment decisions.

To be sure, conflicts of interest between the home country and the MNE can exist on the more fundamental level of whether to allow the outflow of domestic capital in the first place. Balance of payments concerns might call for some restrictions. For this reason, capital export restrictions were imposed in the United States during the Vietnam period. Similarly the interest in keeping jobs in the home country might create labor opposition against foreign direct investment outflows from home countries. See Lindert & Kindleberger, supra note 17, at 459, 475.


Chronologically, the initial negotiation occurs between the MNE and its home country (including the MNE stakeholders in the home country). The interests of the home country and the MNE in limiting MNE liability exposure in the host country are, however, practically congruent. This explains why the MNE is given broad authority to deal with the host country on its own.

23 See generally Schanze, Investitionsverträge im Internationalen Wirtschaftsrecht, 9 STUDIEN ZUM INTERNATIONALEN ROSTOFFRECHT (1986); D. Smith & L. Wells, Negotiating Third World Mineral Agreements (1975) (regarding specifically negotiated investment contracts between MNE and host countries).

24 The liability risk is part of the investment climate in a host country. See Stobaugh, How to Analyze Foreign Investment Climates, 47 HARV. BUS. REV. Sept.-Oct. 1969, at 100; Rums-
countries will likewise include their offered liability regimes in their own social cost/benefit analysis of MNE investment projects.\(^\text{25}\) As a result competition among host countries on one side and the MNE on the other will tend to push the liability regimes negotiated between the MNE and host countries toward ISE.\(^\text{26}\)

To be sure, the MNE/host country market has its imperfections. High transaction costs generally prohibit both project-specific liability arrangements and creditor-specific liability rules. Fraud and opportunism either by the MNE (e.g., incorporation fraud) or the host countries (e.g., arbitrary expansion of a limited liability doctrine by host country courts) can undermine the liability arrangements set in the MNE/host country market. Neglecting third country interests in the formation of liability regimes or systematic political and legal discrimination by host countries against certain creditor groups such as employees or tort creditors\(^\text{27}\) can produce externalities. Such discrimination might even spur an inefficient race for the bottom among host nations.

These imperfections are addressed in various ways. The high transaction costs of negotiating individual liability regimes favor the unilateral drafting of liability laws by host countries. Fraudulent MNE abuses of the limited liability principle for host country subsidiaries can be tackled by providing for adequate rules for piercing the corporate veil. The potential for host country opportunism in the application and development of liability laws can be countered by limiting the reach of host country law and the role of host country courts. Where third countries are affected by activities of the MNE (e.g., through the sale of products from the host country subsidiary to third country constituents), they can claim jurisdictional and regul-
tory powers, thereby avoiding the potential of unwelcome externalities.

In addition, the imperfections in the MNE/host country market favor supplementary markets such as MNE/creditor markets and regulatory markets among nation states. The host country can delegate rulemaking power to the MNE/creditor markets. It will do so where it expects that individual (or organized) creditors are able to negotiate more efficient (case-specific) liability regimes with a MNE. Host country law in the areas of substantive liability law, jurisdiction, and choice of law will, therefore, provide for mere default rules.

Equally, imperfections in the MNE/host country market can activate a regulatory market among home, host, and possibly third countries. The coordination of MNE liability matters through international law can promote efficiency. It helps ease the conflict between overlapping regulatory claims of different national legal systems. It can likewise work towards preventing opportunism by either home, host, or third countries in the use of their legal powers. International agreement on liability floors is another potentially efficient device. Such a standard allows for the protection of easily defrauded or suppressed creditor segments in host countries. This could in fact alleviate the danger of an inefficient race for the bottom among host countries.

Thus, world market forces, i.e., the rational utility-maximizing conduct of the actors involved in the formation of MNE liability regimes, will tend to push MNE liability arrangements towards ISE. The MNE/host country market is the principal level for coordination, but it is supplemented efficiently by MNE/creditor markets and the regulatory market among nation states.

B. The Normative Role of International Social Efficiency in the Formation of Multinational Enterprise Liability Regimes

In principle the development of MNE liability regimes towards ISE is ultimately in the best interests of all concerned. No rational economic actor is against exploiting economic opportunities that would, on balance, make it at least no worse off.

There are, thus, two reasons for those involved in the formation

29 Of course, constitutional law reforms and other internal measures in the respective countries could be a more appropriate and more efficient countermeasure against such distortions. They might, however, not be realizable through outside pressure, rendering international liability floors an efficient second best solution.
30 ISE is understood in this paper along the “Kaldor-Hicks” concept of efficiency, i.e., a rule is efficient if its gains to some actors exceed its losses to others. The compensation of the losers by the winners is not dealt with here, but is, nevertheless, assumed to happen. See Coleman, Efficiency, Utility, and Wealth Maximization, 8 HOFSTRA L. REV. 512, 518-26 (1980).
I. Substantive Multinational Enterprise Liability Rules as a Reflection of an Efficient Allocation of Investment-Related Powers and Risks

A. The Efficiency Merits of Limited Liability for Host Country Subsidiaries

1. Traditional Efficiency Explanations for Limited Liability

Limited liability, including limited liability for subsidiary corporations, is in principle recognized by all market-oriented legal systems around the world. Historically, corporate limited liability was perceived as a spur to socially desirable investment, but the empirical evidence about its positive macroeconomic impact has been inconclusive. Only theoretical analysts have made a plausible case for the efficiency of limited liability. Posner maintains that limited liability is an efficient default rule because it arguably reflects the typical risk-bearing advantages of creditors over public shareholders. Others emphasize the crucial transaction cost saving role of limited liability in primary and secondary equity markets. Limited liability

36 See Halpern, Trebilcock & Turnbull, An Economic Analysis of Limited Liability in Corpo-
limits the cost to shareholders of monitoring management and other shareholders. Additionally, it permits better diversification on the part of shareholders and allows for a relatively inexpensive way to trade shares. Therefore, it promotes the operation of highly liquid securities markets. This in turn contributes to lower costs of capital.\textsuperscript{37}

It is quite plausible that a statutory limited liability rule is efficient as between a dispersed body of individual shareholders and proficient financial creditors such as banks. These creditors are likely to be the superior bearers of at least certain risks associated with the activities of their corporate debtor. Compared to an individual public shareholder such financial creditors are often better able to monitor the activities of a corporation. They will also tend to be better diversified and, thus, less risk averse than public shareholders. Moreover, such creditors are usually compensated for bearing limited liability risks. Furthermore, given the default character of the limited liability rule, contract creditors will be able to negotiate around limited liability where it is efficient to do so.\textsuperscript{38} Doubts about this efficiency explanation for the limited liability rule arise, however, if either the shareholder or creditor paradigms are changed.\textsuperscript{39}

Because a parent company is significantly more aware of the risks stemming from its subsidiary's activities it is a better monitor of such risks; it also tends to be less risk averse than an individual shareholder.\textsuperscript{40} The fact that the role of equity markets is of little importance where parents hold 100\% of the subsidiary stock also weakens the case for limited liability of subsidiaries.\textsuperscript{41}

Likewise, an individual tort creditor having no contractual relations with a corporation will tend to be a poorer monitor of the corporation than a bank creditor. Unlike the latter it will not be compensated for assuming limited liability risks, and it will not be able to contract around the limited liability rule in cases where that would be efficient. In fact, there appears to be agreement in the legal literature that limited liability creates economic deadweight losses through its uncompensated risk externalization to certain

\textsuperscript{37} See contra Meiners, Mofsky & Tollison, \textit{supra} note 34, at 351.

\textsuperscript{38} Posner, \textit{ Corporations, supra} note 35, at 503.

\textsuperscript{39} Blumberg II, \textit{supra} note 33, §§ 4.03.1-2, at 74-80, 5.01-.02, at 93-101.

\textsuperscript{40} A parent company's lesser risk aversion is due to the fact that its shareholders are still protected by its own limited liability shield; that gives the ultimate shareholders the opportunity to diversify themselves independent of the parent's responsibility for subsidiary corporations.

\textsuperscript{41} Some positive effects of limited liability on equity markets will admittedly still exist where a parent does not own all the stock of a subsidiary corporation. Even where a parent owns 100\% of a subsidiary, limited liability can save transaction costs in sales of subsidiary stocks because it will ease the separation of liabilities as between a parent and its subsidiary.
creditors. The situation is particularly grave as between corporate parents and tort creditors of a subsidiary. Thus, applying the same strict limited liability rule to all shareholder/creditor scenarios creates undesirable social cost. It would only be efficient to incur these costs if they are outweighed by the social cost of designing and operating a more differentiated or a different statutory liability regime.

This question seems to be the crux in the discussion over the limited liability rule. On one side are those who advocate the abolition or correction of limited liability for corporate parents in general, or vis-a-vis tort creditors in particular. This argument stresses the social cost of limited liability. On the other hand are those expressing doubts about a differentiated limited liability rule. They emphasize the social cost of tinkering with the principle of limited liability, referring to the impossibility of properly distinguishing between various situations, the potentially higher cost of litigation arising from legal differentiations, and the distortions caused by discriminating between, for example, individual and corporate shareholders.

These recent theoretical discussions notwithstanding, limited liability has never been put to a basic test with regard to its justification in the parent/subsidiary context. The principle originated in a world without corporate groups and was later applied mechanically to subsidiary corporations. No due regard was given to the basic differences between individual and corporate shareholders. As Professor Phillip Blumberg noted

Both as an academic and a political matter, the application of limited liability to corporate groups has never undergone the scrutiny and debate that such a fundamental extension of the doctrine deserves. With the increasing predominance of large corporate groups on the world economic scene, and the increasing emergence of an interdependent world economic order, such re-examination is not only desirable, but inevitable.

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42 See Posner, Corporations, supra note 35, at 520; Halpern, Trebilcock & Turnbull, supra note 36, at 147-149; Easterbrook & Fischel, supra note 36, at 103-104; Blumberg II, supra note 33, §§ 4.03.1-2, at 74-80.
43 Stone, The Place of Enterprise Liability in the Control of Corporate Conduct, 90 Yale L.J. 1, 65-77 (1980).
45 See Note, Should Shareholders Be Personally Liable for the Torts of their Corporations?, 76 Yale L.J. 1190, 1201-204 (1967).
48 Blumberg II, supra note 33, § 3.02.1, at 60.
49 Id., § 5.02, at 101.

The allocation of risk is as important to the MNE investment arrangement with a host country as is the distribution of profit opportunities. Liability rules are one legal device for the allocation of risk.\(^5^0\) As a general matter liability is most efficiently assigned to one who may avoid risk at the least cost.\(^5^1\) This is a combination of three factors: the cost incurred by alternative risk bearers for monitoring risks;\(^5^2\) the relative risk attitudes (diversification) of alternative risk bearers;\(^5^3\) and the legal (opportunity) cost of designing and operating alternative liability regimes.\(^5^4\)

An efficient liability regime optimizes the calculus of these three factors. Monitoring cost and risk attitude patterns shape the comparative risk-bearing advantages of alternative risk bearers. As such they warrant highly complex and differentiated liability arrangements. Yet, it is futile to try to mirror through liability rules all shifts and variations in relative risk-bearing advantages. Legal costs mandate a significant reduction of complexity in the design of liability provisions.\(^5^5\)

Translated into the context of MNE investments in host countries, an efficient allocation of investment risks through liability laws takes into account the relative risk-bearing capabilities of the MNE on one side and the host country society and the host country creditors on the other. An efficient MNE liability regime also reflects the legal cost of designing and operating liability laws in accordance with highly differentiated risk-bearing advantages.

3. Limited Liability as an Efficient Instrument of Political Risk Internalization

As was shown earlier,\(^5^6\) the traditional efficiency explanations

\(^5^0\) Property rules are another alternative. See Coase, The Problem of Social Cost, 3 J.L. & Econ. 1, 2-6 (1960).
\(^5^2\) See Posner, Corporations, supra note 35, at 507; Easterbrook & Fischel, supra note 36, at 99-100; Halpern, Trebilcock & Turnbull, supra note 36, at 134.
\(^5^5\) Kraakman, supra note 54, has most convincingly discussed this perennial trade-off problem. See Kirchner, Ökonomische Überlegungen zum Konzernrecht, 2 Zeitschrift für Unternehmens und Gesellschaftsrecht 214-34 (1985).
\(^5^6\) See supra notes 32-49 and accompanying text.
for limited liability are hardly satisfactory in the MNE parent/subsidiary context. Yet, there is another, heretofore untested, proposition that explains the limited liability rule in light of political risks faced by MNEs in host countries.

Investment risks are not limited to economic risks. In fact, political risks, particularly in foreign countries, are an equally important factor in the evaluation of investment projects.\(^{57}\) Political risks have been most visible in connection with expropriations in socialist and third world countries, but their range is broader. They encompass risks emanating from government action or inaction that negatively affect the profit returns to investors. This includes both outright and “creeping” expropriations. It also covers, for example, failed economic and financial policies and the failure to enforce law and order. It equally encompasses unexpected legal acts by host country institutions, like the unexpected announcement of new parent liability rules detrimental to MNE investors.

In effect, limited liability for host country subsidiaries can be seen as a simple, inexpensive mechanism for the internalization of economic risks by the MNE and of political risks by the host country. Limited liability is an upshot of the risk-bearing advantages of MNEs and host nations.

MNE ownership of host country operations allows for the transfer of capital and technology from home to host countries with minimal transaction cost.\(^{58}\) Ownership efficiently includes the combination of some form of residual risk-bearing and economic control.\(^{59}\) Control, in turn, requires the internalization of risks emanating from the use of control power. Whoever controls a certain chain of events is in the best position to monitor the risks associated with such events with the least expense.\(^{60}\) Hence, a basic case can be made for MNE parent liability to the extent of the parent’s economic control over its host country subsidiary.

The MNE’s control over its host country investment is, however, not absolute. Third parties, the host country government in particular, have power to influence the value and return of the subsidiary. These parties are, in principle, the best monitors of the risks associated with the use of their own power. The situation could efficiently be balanced by making such third parties liable to the MNE in ac-


\(^{58}\) See Lindert & Kindleberger, supra note 17, at 448-553; Williamson, supra note 13, at 273-86.


\(^{60}\) This is basically Eucken’s argument for parent company liability. See Eucken, supra note 44, at 279-85. It is not entirely accurate in that it ignores possible concurrent controls by other actors over the same events and does not take into account risk attitude differences and legal cost. Id.
cordance with the suboptimal use of their power. This is in fact done with private actors who, for example, steal or damage MNE property. Yet it is not done and hardly can be done at reasonable legal cost for government activity.\(^6\)

Thus, neither a host country government nor its “supervisor,” the host country society, will be liable to the MNE for failed economic policies or its inability to maintain law and order. This political risk is not internalized by the host country if no other mechanism can be employed to this end. It results in undesirable and inefficient distortion.

Limited liability for host country subsidiaries offers a second best solution to this imperfection. Instead of leaving the political risk with the MNE, it allocates it partly to the host country. It does this by conceptualizing the independence of the subsidiary company from the MNE parent, and by requiring the parent to capitalize the subsidiary adequately. The subsidiary’s capital reflects the economic risk-bearing advantages of the MNE as a shareholder-owner.\(^6\)\(^2\) It represents the discounted value of those economic risks that are best borne by the MNE.\(^6\)\(^3\) Thus, the MNE parent company pays for its relative risk-bearing advantages by placing an ex ante “bond” with the subsidiary. Denying parent liability beyond the bond amount shifts the remaining risk to the host country society. Hence, the host country society bears at least part of the economic and political risk associated with a MNE investment project for which it is a superior risk bearer.

A simple example demonstrates this. Suppose a MNE decides to set up a subsidiary in a host country. Experience indicates and the host country government affirms that $5 million is adequate capitalization for the planned activities. Solid estimations furthermore suggest that the subsidiary will make profits of $0.5 million annually for the next five years. No dividend payments to the parent are planned for this five year period. Due to failed government economic and trade policies the subsidiary loses money and ends up with assets of

\(^{61}\) The legal cost of controlling government activity through liability law is often prohibitive when it comes to measuring the damaging impacts of economic policies or the governmental inertia in the enforcement of its laws. To be sure, there are exceptions where governments are and can be made liable for certain acts, or where government activity can at least serve as a defense (regulatory compliance defense) to MNE liability.

\(^{62}\) The calculation of the adequacy of capital is difficult and can only be done through rough approximations; the errors made in the assessment of adequate capitalization by courts, other public institutions (e.g., administrative agencies) or contract creditors of a subsidiary do, of course, have to be accounted for as a cost in the social efficiency evaluation of such a system. See Dix, Adequate Risk Capital: The Consideration for the Benefits of Separate Incorporation, 53 NW. U. L. REV. 478, 484-86 (1958); W. HEMMERDE, INSOLVENZRISIKO UND GLÄUBIGERSCHUTZ 277-99 (1985) (Reihe Wirtschaftswissenschaften No. 343).

\(^{63}\) Adequate capital is a function of the business plans and the business volume of a subsidiary; accordingly, the capital will have to be adjusted in the course of the development of these parameters, e.g., through infusion of new capital or retained earnings.
$4 million at the end of the third year of its activities. At this point the subsidiary causes an industrial accident with damages in the amount of $4.5 million. It files for bankruptcy and defaults also on a loan of $1 million and salaries in the amount of $0.1 million.

If the government had acted efficiently, the subsidiary would have commanded assets in the amount of $6.5 million at the end of the third year. It would, thus, have been able to cover all its liabilities and debt. Because the government failed, the subsidiary went bankrupt and $1.6 million remains outstanding. By allocating this loss to the host country society, which is best able to monitor and control its politics, the risks emanating from host country political action are partly internalized. This internalization directs the political incentives of the host country towards ISE. Thus, permitting limited liability for host country subsidiaries is efficient as a second best solution to internalize the political risks stemming from host country government action and inaction negatively affecting MNE host country investments.

B. Efficient Variations to the Limited Liability Rule for Host Country Subsidiaries

The intended internalization of economic risk by a MNE through ex ante capitalization can cause inefficiencies through error in the measurement of adequate capitalization. It can also be upset by the opportunistic or fraudulent use or abuse of the limited liability system by the MNE. The question is whether these factors justify exceptions to the limited liability rule through the establishment of categories of parent liability. If yes, such exceptions should

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64 To be sure, political risks are still borne by the MNE to the extent of its subsidiary capital. Lowering the initial capitalization requirement could partly accommodate that remaining risk.

65 The efficient redistribution of limited liability risk among host country citizens is basically a political question for the host country. The host country society can leave the risks with the respective creditors or share it on a broader scale through public insurance schemes like unemployment insurance and other social safety mechanisms.

66 The measurement of adequate capitalization can be done ex ante through an administrative screening process and periodic balance sheet tests (as is generally done in the banking sector) or through court procedures after the insolvency of a subsidiary (e.g., upon claims to pierce the corporate veil because of inadequate capitalization). See Norton, Capital Adequacy Standards: A Legitimate Regulatory Concern for Prudential Supervision of Banking Activities?, 49 Ohio St. L.J. 1299, 1309-11 (1989); Lovett, Moral Hazard, Bank Supervision and Risk Based Capital Requirements, 49 Ohio St. L.J. 1365, 1379-86 (1989).

67 Opportunism, a breach of contract for example, is a digression from an established standard of conduct for purposes of maximum self-interest. See Williamson, supra note 13, at 47-49.

68 See Halpern, Trebilcock & Turnbull, supra note 36, at 140-42 (warning that "moral hazard" and "adverse selection" problems, i.e., problems associated with the fact that insured persons will take too little precautions and persons taking appropriate precautions will not insure if pooled with less careful persons, may lead to the failure of insurance markets as substitutes for limited liability).
Ideally be narrow and clear-cut so as to preserve the efficiencies of the limited liability rule.

The predictability and measurability of risks best borne by shareholders is easiest if the shareholders are presumed to be both honest (i.e., not fraudulent nor opportunistic) and passive investors. In this case contingencies associated with the use and abuse of invested assets by the shareholders do not have to be accounted for when calculating adequate capitalization. It is sufficient if a liability regime is imposed on directors, officers, and employees. This guarantees proper employment of corporate assets. The mixed system of limited shareholder liability supplemented by liability rules for those carrying out the corporate objectives adequately protects creditor interests.

This presumably efficient combination of ex ante capitalization and ex post liability mechanisms is disrupted when shareholders, parent companies in this case, depart from the norm and become either active investors or dishonest (i.e., fraudulent or opportunistic). The additional risks created by this potential change in the parent's activity patterns must be accounted for either by a stepped-up capitalization requirement or by subjecting the corporate parent to adequate liability rules.

The second alternative seems more efficient. Predicting complex future activity and discounting it for purposes of calculating an adequate ex ante bond is very difficult. The same difficulty exists with regard to opportunism and fraud by a parent company. Parent liability, on the other hand, would not involve such disadvantages. In addition, if it were narrow enough and legally operable, parent liability could even preserve the advantages of the limited liability rule as a means to internalize political risks outside the parent liability exceptions.

In sum, the limited liability rule for shareholders may be efficiently supplemented with parent liability rules. These rules penalize parent activity that goes beyond honest or passive investment. In order optimally to save the advantages of the limited liability rule, these liability exceptions should be as narrowly tailored and as clear-cut as possible. At the same time they must be operable at reasonable legal cost. This calculus suggests three categories of efficient exceptions to the limited liability rule for corporate parents:

69 Unlike private insurance schemes for directors and officers, a consequent ex ante capitalization mechanism for shareholder activity would also have to include intentional acts, which would, of course, increase the moral hazard problem exponentially.

70 The case for these liability categories could presumably be made for other types of shareholders as well and possibly even for creditors of a corporation with a similar influence on corporate affairs as parent companies, like leveraged buyout funds. For a treatment of these issues see Lundgren, Liability of a Creditor in a Control Relationship with its Debtor, 67 MARQ. L. REV. 523 (1984).
abuse of limited liability by a subsidiary to the detriment of subsidiary creditors; (2) dilution or waste of subsidiary assets through interference in subsidiary affairs; (3) direct and separable infliction of damages on subsidiary creditors through the use of the subsidiary. In fact, these three categories of efficient parent liability have already developed or started to develop in various legal systems.

1. Parent Abuse of the Subsidiary

Where an MNE parent company incorporates a subsidiary in a host country, capitalizes it adequately, separates its operations from the rest of the corporate group, and keeps the subsidiary's financial situation sound and in accordance with its business risk exposure, no distortion arises from limited liability. However, where a parent company manipulates these conditions in a fraudulent or opportunistic manner the efficiency of allowing limited liability for the subsidiary disappears.

In principle the lowest cost avoider of foreseeable risk associated with fraud and opportunism is the fraudulent or opportunistic actor itself. Thus, where a parent company, in order to incorporate its subsidiary, furnishes misleading information about the value of the assets paid in kind to the subsidiary, it should bear the risks associated with this fraud. Likewise, when a parent loots its subsidiary by demanding excessive dividends, it undermines the very premises on which the host country granted limited liability. The parent company itself should bear the risks associated with such outright opportunism. Where the damages of such conduct can not be measured a flat disregard of the subsidiary and its liability veil might be the only and most efficient response.

In practically all international jurisdictions the abuse of a corporate entity by shareholders is recognized as a reason to disregard the corporate veil. It is particularly prevalent in the United States, where piercing the corporate veil has, up to this day, remained the principal legal vehicle to establish parent liability. The U.S. piercing doctrine has, to some extent, also stimulated legal developments in other countries.

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71 See OECD, supra note 32, at 8; Blumberg II, supra note 33, at 605-794.
73 See Blumberg II, supra note 33, at 136.
74 The comparative work, R. Serick, Rechtsform und Realität Juristischer Personen: Ein rechtsgleichender Beitrag zur Frage des Durchgriffs auf die Personen und Gegenstände hinter der Juristischen Person (1955), which has been translated into other languages, has had a particular impact on European and also Latin American countries. Several countries where the piercing doctrine is evident are: Denmark, see Clausen, Use of the American Doctrine of Piercing the Corporate Veil: An Argument in
The gist of U.S. piercing law is the disregard of a corporate veil in cases of fraud, absence of corporate formalities, egregious under-capitalization, commingling of assets, and use of control over a corporation to commit wrong. These categories are wrapped into various, sometimes interchangeable, metaphors like "alter ego," "instrumentality," and "agency." At least in principle these situations represent different categories of parent fraud and opportunism in which the limited liability privilege is undercut in an immeasureable way.

Even without detailing U.S. piercing law or exploring the attempts to expand the piercing doctrine the potential for use of this doctrine as an efficient legal response to abuses of the corporate limited liability shield is evident. The only issue is the definition of its proper boundaries. That, in turn, will be easier if the next two categories of efficient parent liability are treated separately.

2. Dilution or Waste of Subsidiary Assets Through Parent Interference

The concept of limited liability for subsidiary corporations is based on the notion of an ex ante capitalization by a passive parent company that honors the subsidiary’s independence. Where a parent company interferes in the affairs of its subsidiary distortions


75 CLARK, supra note 72, at 73.

76 See generally BLUMBERG II, supra note 33, §§ 6.02-.06, at 112-28.


80 This is exactly where current U.S. law seems to fail. It tends to look at piercing law as a panacea for almost all situations of efficient parent liability, which is a suboptimal approach. Hofstetter, Europe, supra note 77.

81 Some form of parent interference seems to be the rule in the modern MNE, which is often organized along the divisionalized M-form. See WILLIAMSON, supra note 13, at 273-
follow if the risks posed by such parent activity are not internalized with the parent as the best monitor of its own acts.

A traditional, though narrow, device belonging to the basic legal equipment of all market-oriented jurisdictions addresses this category of parent conduct. Fraudulent conveyance law, if applied to subsidiary/parent transactions, protects the subsidiary's assets against specific acts of depletion by the parent.\(^8\) As a finely tailored set of rules fraudulent conveyance law is, in principle, efficient. Being restricted to remedying damaging consequences of specific acts, fraudulent conveyance law has efficiency advantages over broadly sweeping rules like piercing the corporate veil.\(^8\) Its operability in the parent/subsidiary context is questionable, however, where the interaction between parent and subsidiary is intense. The legal cost\(^8\) of fraudulent conveyance law can become prohibitive under such circumstances and might justify rule simplification.

Equitable subordination law has attempted such simplification,\(^8\) but the potential to overreach, to cases of efficient parent loans\(^8\) for example, requires a restriction of its applicability to situations involving some discernible form of impropriety.\(^8\) This tends to narrow its scope to cases similar to those subject to piercing or fraudulent conveyance law.\(^8\) The value of equitable subordination as a device to check parent activity seems, therefore, limited.\(^8\)

In contrast, efficiency generally requires that all parent activity that suboptimally affects the subsidiary's capital be put under an adequate liability regime. This necessity exists all the more because the absence of a takeover market for subsidiary corporations leaves lia-


\(^{82}\) For a discussion of the United States see Blumberg I, supra note 32, at 285-398; Clark, supra note 72, at 40-52; for Germany see Konkursordnung §§ 29-42; for Switzerland see Schuldbezeichnungs und Konkurs Gesetz Arts. 285-92.

\(^{83}\) Regarding the limitations of piercing law, see generally J. Wilhelm, Rechtsform und Haftung bei der Juristischen Person (1981). See also Vagts, Konzernrecht in den Vereinigten Staaten, in Das St. Galler Konzernrechtsgespräch 39-42 (J. Druey ed. 1988).

\(^{84}\) Legal costs include the direct cost of enforcing a rule and the opportunity cost of non-enforcement of the rule.

\(^{85}\) See Clark, supra note 72, at 52-71; see also the development of a similar rule in German law, Schiesl, The Liability of Corporations and Shareholders for Capitalization and Obligations of Subsidiaries Under German Law, 7 Nw. J. Int'l L. & Bus. 480, 487-88 (1987).

\(^{86}\) See Posner, Corporations, supra note 35, at 517-18.


\(^{88}\) See Clark, supra note 72, at 54-55, 65-69; Blumberg II, supra note 33, at 119-27.

ability as the only device to protect the subsidiary assets from dilution and waste by those in charge.\textsuperscript{90} Where the principle of limited liability for subsidiary corporations is strictly followed, despite constant and pervasive interferences by the parent company in the subsidiary’s affairs, serious distortions must arise.

Unlike U.S. law, which seems to suffer under the dominance of a metaphorically applied piercing concept,\textsuperscript{91} European laws have developed sensitivity to this issue.\textsuperscript{92} French, Swiss, and proposed EC law work with a de facto director notion that puts parent companies under the same fiduciary duties as corporate directors and officers.\textsuperscript{93} German law for de facto concerns uses a similar compensation regime. Yet the cost faced by subsidiary creditors to enforce these regimes has been almost prohibitive. The difficulties in designing a separate subsidiary interest as a prerequisite to defining the parent’s fiduciary duties and the damages incurred by the subsidiary tend to work in only the most egregious circumstances. Furthermore, the risks associated with derivative suits by creditors are often too high to warrant litigation, particularly for smaller creditors. As a consequence, the practical impact of these laws has not been very different from that of the conceptually more limited piercing doctrine in the United States.\textsuperscript{94}

Various European concepts, however, have adopted simplified schemes for highly integrated corporate groups. These can be seen as an attempt to compromise the described enforcement problems. Particularly efficient appears the German parent liability model for “qualified concerns.”\textsuperscript{95} Where the interaction between parent and subsidiary corporations becomes so intense as to render them impenetrable for outsiders, the burden of proof about damaging influences on the subsidiary shifts to the parent. Simultaneously, creditors acquire a direct claim against the parent company. This solution takes account of the enforcement difficulties associated with the pure compensation regimes like the de facto director concept. At the same time it saves the basically efficient principle of limited liability for even highly integrated concerns.\textsuperscript{96}

\textsuperscript{90} See Meier-Schatz, Über die Notwendigkeit gesellschaftsrechtlicher Aufsichtsregeln, 107 ZEITSCHRIFT FÜR SCHWEIZERISCHES RECHT 191 (1988). Alternatively, even though not necessarily more efficient, contractual control or compensation mechanisms exist for proficient contract creditors, like banks, but they are not available to others, like tort creditors.

\textsuperscript{91} See Blumberg II, supra note 33, § 6.07, at 130-31.

\textsuperscript{92} See generally Hofstetter, Europe, supra note 77.

\textsuperscript{93} See id. at 8-9, 13-14, 16-19.

\textsuperscript{94} Id. at 23-24.

\textsuperscript{95} Id. at 10-11. See also id. at 6-8 (discussing the regimes for integration and contract concerns).

\textsuperscript{96} This is unlike the situation for the integration concern where parent liability attaches per se. See id. at 6-7.
3. Direct and Separable Impairment of Subsidiary Creditors by a Parent

The same efficiency reasons which favor some form of parent liability for damaging interferences with subsidiary affairs also call for liability where a parent inflicts direct damages on subsidiary creditors. The transition between the two categories is in any case continuous, as the German "qualified concern" doctrine indicates.

It is efficient to hold a parent company, like any other third party, liable for directly damaging acts to subsidiary creditors. The internalization of such acts through an ex ante capitalization rule creates a massive moral hazard problem. Liability rules, on the other hand, can be fine tuned within the sophisticated structures of contract and tort law. These laws can be flexibly geared to address shareholder conduct without using the radical approach of piercing law. The roles of contract and tort law as supplements to the limited liability principle have most thoroughly been outlined in German law by Eckard Rehbinder. Phillip Blumberg has attempted a similar approach in the United States.

Tort law, through such concepts as duty of care, proximate cause, and damages, lends itself to a differentiated reflection of risk-bearing advantages. It can be applied to sanction parent company conduct by taking account of the degree and type of parent involvement with the subsidiary. At the same time it allows for adjustments to the particularities of tort creditors as usually inefficient and uncompensated bearers of limited liability risk.

Blumberg refers to the notion of "assumption of duty" as it has been used by U.S. courts in construing parent liability for workplace security. This concept seems indeed to have potential as a flexible device to get parent activity under efficient liability control.

Another tort law instrument to be used efficiently as a parent liability mechanism is vicarious liability.


Where a hierarchical rela-

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97 Where direct impairment of a creditor's position by parent activity can be established, this is, of course, preferable to compensating the creditors indirectly through making the parent liable to the subsidiary.
98 See supra note 95 and accompanying text.
99 See Easterbrook & Fischel, supra note 36, at 104; Halpern, Trebilcock & Turnbull, supra note 36, 140-41.
101 See BLUMBERG II, supra note 33, §§ 12-19, at 231-325.
102 Hofstetter, Europe, supra note 77, at 20.
104 See Hofstetter, Europe, supra note 77, at 19-20; REHBINDER, supra note 100, at 521-47. See generally Sykes, The Economics of Vicarious Liability, 93 YALE L.J. 1251 (1984) refer-
tionship between the parent and the subsidiary has been established the proposal suggests a rebuttable presumption of parent liability for subsidiary torts. The parent’s liability would then be commensurate with its involvement with the subsidiary.\(^{105}\)

Another tort law concept that lends itself to application in the parent/subsidiary relationship is interference with third party contracts.\(^{106}\) Similarly, contract law devices protecting the trust of subsidiary creditors on the financial backing of the parent can have efficiency-promoting effects. They allow for the legal recognition of parent commitments if, for example, the parent behaves as a direct contractual partner of subsidiary creditors.\(^{107}\)

French labor law takes that approach. It provides for parent co-liability where the parent company involves itself in the employment affairs of the subsidiary.\(^{108}\) French law thereby follows the notion that the subsidiary employees should not be burdened with proving either the parent’s infliction of damages on the subsidiary or their right to rely on the parent’s conduct as an expression of its direct financial responsibility to subsidiary employees. Given the usually small claims of employees and their typical risk-bearing disadvantages,\(^{109}\) this solution is attractive from an efficiency standpoint.\(^{110}\)

The Bhopal case demonstrated another potentially efficient application of tort or contract law. In the complaint filed in the United States, Union Carbide was accused of having breached its promise to the Indian government that it would use state of the art technol-

\(^{105}\) To a limited extent tort law has also taken care of the parent liability problem in, e.g., U.S. products liability law. A parent can become jointly liable with its subsidiary where it is involved in the production, marketing, or sale of a subsidiary product. Blumberg II, supra note 33, at xlii.


\(^{107}\) See Blumberg II, supra note 33, at 296-300; Rehbinder, supra note 100, at 293-343; Bosmann, supra note 100, at 83.

\(^{108}\) Hofstetter, Europe, supra note 77, at 14-15.

\(^{109}\) See Williamson, supra note 13, at 52-56 (noting employees particularly high asset specificity).

\(^{110}\) Hofstetter, Europe, supra note 77, at 15. It could be argued, however, that some form of a parent defense, e.g., a regulatory compliance defense, should be granted at least for tort claims of employees on the assumption that tort claims are usually larger than the wage and severance payment claims of employees. See supra note 61 and accompanying text (discussing the justification of a parent defense as an efficient means to internalize political risks). See also infra notes 113-24 and accompanying text (discussing MNE liability to weak creditor groups).

\(^{111}\) See Count VI of the Complaint filed in the United States, supra note 7.
ogy at its Indian plant. Instead of solving this issue under the inflexible concept of piercing the corporate veil it could be more readily tackled as a problem of international law or host country contract or tort law. This would allow for flexible case-to-case adjustments, thereby promoting efficiency.

C. Additional Considerations Regarding the Limited Liability Rule

1. Per Se Parent Liability vis-a-vis Weak Creditor Groups

Weak creditor groups, like consumers and tort creditors, are the focus of much legal discussion where limited liability is concerned. The ability of these groups to bear the risks of limited liability is doubtful. These creditor groups tend to be relatively undiversified individuals whose risk-bearing capabilities compare unfavorably with those of better diversified corporate groups. In addition, the prohibitively high information costs faced by these creditors can prevent their efficient compensation by shareholders for bearing the risk of limited liability.

Thus, distortions likely will occur under a rule of limited liability. But per se parent liability vis-a-vis these creditor groups has its own inefficiencies. First, these creditor groups might not always bear the risks of limited liability less efficiently than shareholders. In this case, the shareholders would, under a rule of unlimited shareholder liability, face transaction costs, though less severe, in renegotiating the allocation of liability risk. Second, and more important, is the function of limited liability as a device to internalize political risk. Abolishing limited parent liability vis-a-vis all weak creditor groups would diminish the effectiveness of the rule as an efficiency constraint on political acts by host countries.

In the tort area, where the consequences of tort-related government action, e.g., negligent control of hazardous activities, can be disastrous, the distortion could be substantial. This suggests the superiority of resorting to lesser forms of parent liability, like vicarious liability, that give the parent a defense in case of proven misconduct on the part of the host country. It likewise strengthens the case

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113 See Halpern, Trebilcock & Turnbull, supra note 36, at 145-47; Easterbrook & Fischel, supra note 36, at 107-09; Posner, Corporations, supra note 35, at 519-20; Blumberg II, supra note 33, at 74-80; Stone, supra note 72, at 68.
115 Posner, Corporations, supra note 35, at 520.
116 To be sure, direct governmental liability could sometimes correct the situation. But the uncertainty of its availability and its correct application by host country courts involve significant risks and potential inefficiencies, supra note 61.
for liability substitutes,\textsuperscript{117} such as administrative controls for hazardous activities, or government ex ante controls of product and workplace safety.\textsuperscript{118}

Mandatory insurance schemes are another alternative to prevent per se parent liability. Insurance could be private\textsuperscript{119} or public. In a public scheme the host country society as a whole could be the insurer and the MNE might be obliged to pay adequate premiums through taxes or other forms of contribution. Unemployment insurance for employees and public health programs for tort creditors are examples of such public insurance schemes.

Bankruptcy privileges for tort creditors, consumers, or employees are additional devices to alleviate limited liability risks of weak creditors.\textsuperscript{120} Even participatory rights or organizational means given to weak creditor groups can partially substitute for liability protection.\textsuperscript{121} Codetermination,\textsuperscript{122} unionization for employees,\textsuperscript{123} and recognition of consumer organizations can improve the control mechanisms available to such creditors. They make ex post controls through liability rules less important in certain instances.\textsuperscript{124}

\textsuperscript{117} See Easterbrook & Fischel, \textit{supra} note 36, at 114-17 (stressing substitutes such as minimum capital requirements, mandatory insurance, managerial liability, and regulation). See also Posner, \textit{Corporations}, \textit{supra} note 35, at 520 (suggesting the placement of a "tort" bond by the shareholders); Halpern, Trebilcock & Turnbull, \textit{supra} note 36, at 147-50 (stressing the role of directors' liability as a creditor safeguard); Kraakman, \textit{supra} note 54, at 872-76 (scrutinizing the potential of managerial liability and suggesting that limited liability as a "bankruptcy insurance" should be evaluated against "the yardstick of alternative private insurance mechanisms").


\textsuperscript{119} At least for some areas (e.g., tort risks) a private market could be expected to work.

\textsuperscript{120} To the extent that contract creditors are put behind tort and other privileged creditors in the bankruptcy priority order, they might negotiate for adequate capital for the preceding creditors, too. Tort creditors would, thus, become "efficient free riders" on the contract creditors' attempt to internalize risks with the MNE. See Halpern, Trebilcock & Turnbull, \textit{supra} note 36, at 131-32.

\textsuperscript{121} See Coase, \textit{supra} note 50.

\textsuperscript{122} See Teubner, \textit{Corporate Responsibility, als Problem der Unternehmensverfassung, 1 ZEITSCHRIFT FÜR UNTERNEHMENS UND GESELLSCHAFTSRECHT} 34-56 (1983).

\textsuperscript{123} The "Vredling" proposal in the EC purported to give subsidiary employees a right to be informed about strategic decisions made on the parent company level. Such information rights would, in turn, improve the bargaining position of employees and help prevent such surprises as the "Badger" bankruptcy which involved a sudden closing of a Belgian subsidiary by a U.S. parent, leaving the employees without financial coverage for their severance payment claims. For a discussion of the Badger case and the "Vredling" proposal, see R. Blanpain, \textit{The Badger Case and the OECD Guidelines for Multinational Enterprises} (1977); R. Blanpain, \textit{The Vredling Proposal: Information and Consultation of Employees in Multinational Enterprises} (1983).

\textsuperscript{124} A certain drawback of participatory rights is their dilution of responsibility and the concomitant difficulty in the application of liability rules in general. The problem comes to the surface in connection with parent liability to subsidiary employees under German law if the employees were themselves represented on the parent board through codetermination. See V. Emmerich & J. Sonnenschein, \textit{Konzernrecht} 86-90 (3d ed. 1989).
These functional substitutes for the outright abolition of limited liability honor the rule as an efficient means of political risk internalization. But they correct some of the distortions arising from the imposition of limited liability risk on “weak” creditor groups.

2. Different Parent Liability Regimes for Domestic Corporate Groups?

Limited liability for subsidiary corporations owned and controlled by foreign parent companies is efficient because of its potential for the internalization of political risk by the host country’s political system. The same argument justifies limited liability for subsidiary corporations owned and controlled by domestic parents.\(^\text{125}\) Even though domestic parent companies are part of the domestic political system, they bear political risk less efficiently than the domestic political society as a whole.\(^\text{126}\) Furthermore, inefficient liability rules discourage foreign investment as well as domestic investment.\(^\text{127}\) There is, thus, equal reason to protect domestic parent companies from the burden of bearing political risk by recognizing limited liability for their subsidiary corporations. In addition, the economic risk best borne by a domestic parent company is not fundamentally different from that best borne by a foreign parent company. The monitoring cost and risk attitude patterns of foreign parents are not systematically different from those of domestic parent companies.\(^\text{128}\)

To be sure, there may be differences in the legal cost of enforcing parent liability rules against a MNE as opposed to domestic groups. Limited host country jurisdiction, practical difficulties in litigating against a foreign parent company, and complications in the enforcement of judgments against foreign parents complicate reliance on parent liability rules for the control of a MNE. Yet these additional costs of enforcement do not necessarily require narrower parent liability rules for foreign as opposed to domestic parent companies. Increased administrative control over the adequate capitalization of foreign-owned subsidiaries might suffice.\(^\text{129}\) Likewise,

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\(^\text{125}\) The argument could be extended to limited liability corporations in general, but this is not the topic discussed here.

\(^\text{126}\) Only some form of special domestic social contract, e.g., some compensation scheme through favorable tax treatment, might justify political risk-bearing by parent companies.

\(^\text{127}\) This is increasingly the case in an environment of international financial deregulation.

\(^\text{128}\) The MNE’s higher monitoring cost due to the greater geographic and cultural distance between the home and host country might, on average, be offset by its better worldwide infrastructure for the control of subsidiary activities.

\(^\text{129}\) Examples of such control include screening of initial capitalization, dividend payout restrictions, transfer pricing controls, and financial disclosure requirements. See Note, *The Role of India's Foreign Investment Laws in Controlling Activities of Multinational Corporations*,
liability-prone activities might be closely supervised when carried out by foreign-controlled subsidiaries. Such alternatives can, thus, put domestic and foreign parent companies on an equal footing and render their identical liability treatment possible and efficient.

D. Optimizing Substantive Multinational Enterprise Liability Law

Efficient MNE liability laws are a function of the political and legal context in which they apply. In theory, the smaller the political risk faced by the MNE, the less compelling the case for limited liability of its host country subsidiary. Moreover, differences in the legal rules that substitute for or supplement liability law will influence the optimal liability regimes applicable to a MNE.

Consequently, optimal MNE liability rules might vary among different political and legal systems. Leaving the negotiation of MNE liability rules to the MNE/host country and MNE/creditor markets will presumably create adequate country-specific or even creditor-specific results. However, given transaction cost barriers in these markets, host country legislators and courts play a crucial role in bringing optimal liability regimes to bear.

But legislators and courts, particularly in third world countries, might sometimes be unable to make sophisticated cost/benefit analyses about efficient MNE liability regimes. In addition, the subtle, structural, or outright suppression of certain creditor interests in host countries might bias MNE liability laws against such groups as tort creditors and employees. Furthermore, competition among nations for foreign investment could aggravate the situation by spurring a race for the bottom among host nations to the detriment of such creditor groups.

This situation calls for international standardization through comparative law, international guidelines, or even international minimal standards. In addition, if MNEs faced similar liability regimes


150 Equality of treatment between the two types of parent companies has efficiency advantages because it prevents delineation problems and the potential of distortion through inadequate differentiation. It also eases the transaction cost of changing from one category into the other.

151 Herein lies an efficiency-relevant aspect of the often diagnosed inequality of bargaining power between MNEs and third world countries. The "dependencia" school, subscribing to the view that MNEs unfairly exploit their superior power vis-a-vis third world countries is, however, broader and seems more concerned with distributional than with efficiency questions. See Encarnacion & Wells, supra note 25, 37-39; R. BARNET & R. MULLER, GLOBAL REACH: THE POWER OF MULTINATIONAL CORPORATIONS 137-47 (1974).

152 When it comes to practical law-making, the job will not be easy in any event. Exact quantifications are not possible. Efficient rules can thus only be designed by way of approximations. Furthermore, in practice every country will, to a certain extent, have to consider factors other than efficiency in designing and interpreting liability laws. See Siliciano, Corporate Behavior and the Social Efficiency of Tort Law, 85 Mich. L. Rev. 1820, 1823-34 (1987).
across the globe, they would face decreased legal transaction cost. In fact, the principle of limited liability for subsidiary corporations and the three categories of efficient parent liability are of such a general nature that they might fit into most national legal systems. It seems worthwhile to attempt such a scheme internationally. One step in this direction can already be seen in the context of the OECD Guidelines for MNE. Starting with the Badger Case, the OECD has issued several opinions defining and interpreting the responsibilities of MNE parents with regard to their host country subsidiaries. Though vague, the liability standards enunciated in these opinions attempt to reflect the relative control power of MNE parent companies over their foreign subsidiaries.

IV. Choice of Law and Procedural Rules as a Reflection of an Efficient Allocation of Legal Powers and Risks

The host country has a role in the formation and operation of the liability rules applicable to MNE host country activities. This host country power adds to the potential for host country opportunism or fraud and, thus, to political risk. In particular, political risk is inherent in host country authority to create, amend, interpret, apply, and enforce MNE liability rules.

Part III of this Article construed limited liability as a global cap on political risk faced by MNE host countries. However, limited liability is just second best as a means to internalize political risk. Where more direct ways of limiting separable political risks are available, they are preferable.

Several different choice of law and procedural mechanisms offer straightforward limitations and checks on the use of legal authority by host countries. They allow for an efficient allocation of legal powers to host countries along with optimal limitations of political risks.

135 For example, note the large degree of uniformity that already exists in the area of corporate liability law today (even including socialist countries, as far as foreign investment is concerned). See supra note 32 and accompanying text.
136 See BLANPAIN, THE BADGER CASE, supra note 123, at 70-77.
137 See generally ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD), THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (1986) [hereinafter OECD GUIDELINES]. See also Legal Problems of Codes of Conduct for Multinational Enterprises (N. Horn, ed. 1980); Steg, Internationale Verhaltensregeln für internationale Investitionen und multinationale Unternehmen, in ZEITSCHRIFT FÜR UNTERNEHMENS UND GESSELLSCHAFTSRECHT 1 (1985); Coombe, Multinational Codes of Conduct and Corporate Accountability: New Opportunities for Corporate Counsel, 36 Bus. Law. 11 (1980).
139 Id.
A. Comparative Regulatory and Adjudicatory Advantages for Multinational Enterprise Activity in Host Countries

1. The Case for the Choice of Host Country Liability Law

Apart from third country and international law, host or home country law will provide the basis for MNE liability. International Social Efficiency mandates that this choice be made based on comparative regulatory advantages, i.e., the relative ability of the two countries to design the most effective liability laws at the least cost.  

There are various factors, in trade-off relations to each other, that determine comparative regulatory advantage. First, there are dynamic factors such as the general competence and speediness of the respective law-making institutions, and the direct cost of the law-making process. These factors do not favor either host or home country rule in a general sense. Instead, they require a case-by-case analysis, regardless of the difficulty.

Second, there are static efficiency factors that basically favor host country liability law as a control mechanism over MNE host country activities. These factors are more problem-specific. They are rooted in the fact that MNE host country activities take place within the general political and legal realm of the host country. The political and legal system of the host country is closer to the fact patterns to be regulated. The host country also tends to regulate the substitute and supplementary areas to liability law.  

As a result, it is in principle efficient to let the host country establish liability rules for MNE host country activities. But the host country's comparative regulatory advantage for liability law fades as the home country regulatory advantage increase. Thus, at some point advantage for regulating MNE liability shifts to the home country. The concept of independent subsidiaries with limited liability helps ease this demarcation problem. It makes possible a relatively clear separation between host country activity (i.e., subsidiary activity

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140 See Posner, ECONOMIC ANALYSIS OF LAW, supra note 54, at 553-54 (attempting to put choice of law rules in an efficiency framework); Siehr, Ökonomische Analyse des Privatrechts, in FESTSCHRIFT FÜR KARL FIRSCHING ZUM 70. GEBURTSTAG 269 (1985) (placing the choice of law efficiency analysis in an international context).


142 Of course, where dynamic factors disfavor the host country rule because of an unable or corrupt law-making process, home country rule might be a more efficient solution. It is expected that the MNE/host country market, or at least the MNE/creditor markets, will tend to lead to provisions for the application of host country law in these cases.
subject to host country law) and home country activity (i.e., parent activity subject to home country law).

But this simple choice of law concept does not always hold. In the MNE parent liability area it needs to be supplemented to cover the cases of efficient exception to the limited liability rule. Yet the static factors determining comparative regulatory advantage seem to favor host country law for the regulation of these situations, too. The host country law-making process is closest to the host country activities of the MNE parent. It should also be best able to assess such parent activity in the context of the general control regime over MNE host country activities. The host country seems, thus, in the best position to determine the optimal liability sanctions for MNE parent conduct affecting the host country.

Accordingly, it is efficient to apply host country liability law to host country activities of both MNE subsidiaries and parent companies.\textsuperscript{143} The efficiently restricted liability exposure of MNE parents for their host country activity also limits the political risk associated with host country regulatory authority over MNE parents. To be sure, it does not exclude the potential efficiency of additional safeguards against these political risks.\textsuperscript{144}

A comparative synopsis of choice of law principles governing the host country activities of MNEs reveals a partly uneven,\textsuperscript{145} yet obvious trend in the direction of the efficiency principles just mentioned. It is almost uniformly recognized that subsidiary corporations are subject to host country law.\textsuperscript{146} Thus, the limited liability principle, as well as its foil—piercing the corporate veil—tend to be treated in accordance with host country law.\textsuperscript{147} Other parent liability excep-

\textsuperscript{143} See Behrens, \textit{Der Durchgriff ueber die Grenze}, 46 RABELS ZEITSCHRIFT FUER AUSLAENDisches und INTERNATIONALES PRIVATRECHT 308, 341-48 (1982).

\textsuperscript{144} See notes 56-65 and accompanying text.


\textsuperscript{146} The Anglo-American incorporation theory is basically applied in the United States and Switzerland. See Kozyris, \textit{Corporate Wars and Choice of Law}, 1985 DUKE L.J. 1, 15 (1985); Forstmoser, \textit{supra} note 74, at 113-14. The Continental European "seat theory" is applied in Germany. See G. KEGEL, \textit{INTERNATIONALES PRIVATRECHT} 365-66 (6th ed. 1987); Tzouganatos, \textit{supra} note 141, at 479-87. The "seat" theory is one way to prevent externalities to third countries, where the center of gravity of a subsidiary's activities is different from its place of incorporation.

\textsuperscript{147} See BLUMBERG II, \textit{supra} note 33, § 27.05, at 666; Kozyris, \textit{supra} note 154, at 64-65; A. ROHR, \textit{DER KONZERN IM IPR UNTER BESONDERER BERÜCKSICHTIGUNG DES SCHUTZES DER
tions are, where they exist, often also subject to host country law. Choice of law principles for German concern law,\textsuperscript{148} Swiss de facto director law,\textsuperscript{149} or tort,\textsuperscript{150} contract,\textsuperscript{151} and fraudulent conveyance law\textsuperscript{152} generally favor the application of host country law to the host country activities of MNE parents.

2. The Case for Host Country Jurisdiction

Apart from third country courts, international courts, and arbitration,\textsuperscript{153} adjudication of MNE liability disputes comes down to a choice between host and home country jurisdiction. An efficient decision is guided by comparative adjudicatory advantages, \textit{i.e.}, the ability of the respective court systems to adjudicate a matter in an inexpensive, expeditious, and accurate manner.\textsuperscript{154}

Comparative adjudicatory advantage also consists of dynamic and static factors. Dynamic factors include the speed, independence, and competence of the court system, as well as the direct costs of litigation. These factors do not clearly favor the court system of either host or home country. Static factors, however, tend to favor host country over home country jurisdiction for the adjudication of MNE activities in host countries. First, the actions subject to adjudication primarily occur in the host country. This gives host country courts better access to evidence and witnesses. Furthermore, if host country rule governs it can be assumed that host country courts will be in a better position to apply and interpret the applicable law.\textsuperscript{155}

This efficiency calculus for comparative adjudicatory advantage


\textsuperscript{149} International Private Law Statute Art. 155 [hereinafter IPLS].

\textsuperscript{150} Restatement (Second) of Conflict of Laws §§ 145, 146 (1971) (United States); Blumberg II, \textit{supra} note 33, at 643 (United States); IPLS Arts. 133-35 (Switzerland); Kegel, \textit{supra} note 146, at 450-61 (Germany).

\textsuperscript{151} Restatement (Second) of Conflict of Laws § 188 (United States); Blumberg II, \textit{supra} note 33, at 658-66 (United States); IPLS Art. 117 I (Switzerland); Einführungsgesetz zum Bürgerlichen Gesetzbuch Art. 28(I)(1) (Germany); Kegel, \textit{supra} note 146, at 426 (Germany).

\textsuperscript{152} At least in host country courts. \textit{See, e.g.}, IPLS Art. 171 (Switzerland).

\textsuperscript{153} Some past attempts by MNEs to get exemption from courts in third world countries included submitting to international arbitration for all disputes in connection with MNE activities in the respective host countries.


\textsuperscript{155} Over time host country courts will presumably develop "economies of scale," \textit{i.e.}, create a vast body of court made law rendering adjudication easier or in some cases unnecessary.
favors host country jurisdiction over host country subsidiaries. The same reasons also favor host country jurisdiction over MNE parent companies for the three categories of efficient exceptions to the limited liability principle. In addition, such a rule would allow a consolidation of the often similar liability actions brought against a subsidiary and its parent.

The restrictions built into the limited liability rule, and the narrow exceptions to it, themselves contain a limitation of the political risks inherent in host country jurisdiction. Again, this certainly does not preclude the efficiency of additional safeguards against political risks associated with host country jurisdiction.\textsuperscript{156}

A synopsis of jurisdictional rules in various countries reveals that international jurisdiction over the host country activities of MNEs roughly follows comparative adjudicatory advantages. The general jurisdiction of host countries over host country subsidiaries is basically undisputed.\textsuperscript{157} Host country jurisdiction over foreign parent companies, on the other hand, is less uniform. In some countries jurisdiction goes either too far\textsuperscript{158} or not far enough from the perspective of ISE.\textsuperscript{159} But parent liability laws are sometimes efficiently accompanied by rules providing for special host country jurisdiction. Examples include Swiss jurisdiction for the adjudication of de facto director laws\textsuperscript{160} and the almost universally recognized tort jurisdiction at the location of the occurrence of a tort.\textsuperscript{161} The U.S. minimum contacts doctrine contained in most long-arm statutes allows for case-specific jurisdiction over foreign parent activity in the United States.\textsuperscript{162} This flexible approach does have the obvious potential to become too broad and unpredictable, but it also may be fine tuned along efficiency lines.\textsuperscript{163}

Host country jurisdiction for the adjudication of MNE activities

\textsuperscript{156} See notes 56-65 and accompanying text.


\textsuperscript{158} An example is the German "Vermögensgerichtsstand" which provides for general jurisdiction based on any assets within Germany owned by foreign defendants. Zivilprozessordnung § 23 [hereinafter ZPO]; V. Herman, J. Basedow & J. Kroppholler, Handbuch des Internationalen Zivilverfahrensrechts 314 (1982). Another example, the Swiss "Arrestgerichtsstand" provides for limited jurisdiction at the location where assets of foreign defendants have been attached. See ILPS Art. 4, supra note 149; Schnyder, supra note 145, at 23-24.

\textsuperscript{159} See Behrens, supra note 143, at 350.


\textsuperscript{161} IPLS Art. 129, supra note 149 (Switzerland); ZPO § 32 (Germany). See Herman, Basedow & Kroppholler, supra note 158, at 344. See also ZPO § 29; IPLS Art. 113, supra note 149 ("Erfüllungsgerichtsstand" in Germany and Switzerland provides for jurisdiction at the place of contractual performance for contract claims).

\textsuperscript{162} See, e.g., N.C. Gen. Stat. § 1-75.4 (1989) (a typical state’s long-arm statute).

\textsuperscript{163} A jurisdictional piercing test comparable to the piercing test under substantive parent liability law would allow for the proper limitation of host country jurisdiction over foreign parents. See Blumberg III, supra note 157, at 74-76. See also Hay, Judicial Jurisdiction Over Foreign Country Corporate Defendants, 63 Or. L. Rev. 431, 433-35 (1984); Cohen, In
in host countries is frequently not exclusive. Broad assertions of concurrent home country jurisdiction exist for these situations. This reflects the determination of home countries to protect MNEs against political risks lurking in host country courts.

3. Efficient Home Country Checks on Host Country Liability Laws and Adjudication

The political risk associated with the use of legal powers by host countries can be countered with various home country measures. Concurrent home country jurisdiction, limitations on the procedural reach of host country procedures (for example, through home country limitations on legal assistance), refusal to enforce host country judgments in the home country, and public order exceptions in choice of law rules are some possibilities. The potential for their efficiency follows from the substantial discretion of host countries in the use of their legal powers over MNE host country activities.

It is plausible that some of these measures are adequate as a threat to host countries and, thus, as a means to limit and internalize political risk. Due to their flexibility and narrowness they might be an optimal supplement to the political risk limitations already in place. They could, thus, be part of an optimal mix with the safeguards built into the limited liability rule, the restrictions on host country regulatory and adjudicatory powers, and the potential sanctions against host countries in the MNE/host country market.

On the other hand, the specific home country checks on the use of legal powers by the host country are costly and they may be overbroad. One cost of concurrent jurisdiction is forum shopping. It invites opportunism among plaintiffs and hampers the optimal restriction of home country jurisdiction over MNE host country activities to cases where host country jurisdiction would be less efficient. The doctrine of forum non conveniens, particularly as used by U.S. courts, seems an ideal measure to fine tune the allocation of jurisdictional power to host countries on a case-by-case basis. Its use by U.S. courts in conjunction with the Bhopal case exemplifies this po-


Note, United States Based Multinational Corporations Should be Tried in the United States for Their Extraterritorial Toxic Torts, 19 VAND. J. TRANSNAT'L L. 651, 670 (1986).

Other broader means might be general, political, or economic retaliatory measures. See Hickenlooper Amendment in the United States, 22 U.S.C. § 2370(e)(1) (1988); Vagts, supra note 57, at 12.

See Kropholler, Das Unbehagen am Forum Shopping, in FESTSCHRIFT FÜR KARL FIRSCHING ZUM 70. GEBURTSTAG 165-173 (1985); Juenger & Sämthlen, Der Kampf ums Forum, in RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATERECHT 708 (1982).
Weighing private and public interests, as done in the Bhopal case, allows for the inclusion of an international efficiency calculus measuring comparative adjudicatory advantages. The competence and independence of host country courts, their speediness, and the efficiency of the substantive law likely to be applied can all be included in this rationale.

Nonenforcement of judgments is costly in that it might require repetitive procedures over the same issues in host and home country courts. Thus, overly broad enforcement restrictions for foreign judgments will be inefficient. An analogous case can be made for restrictions on granting legal assistance to host country courts.

The potential for overbroad home country safeguards represents in itself a political risk factor. The possible opportunistic use of such safeguards by home countries appears as a political risk from the perspective of host countries and host country creditors. This, in turn, calls for safeguards in favor of host countries. The exposure of subsidiary assets to host country jurisdiction, the allocation of certain legal powers to host countries, and the potential sanctions against MNEs in the MNE/host country market will give host countries some comfort, but possibly not enough.

In any case, there is a potential for mutual opportunism and conflicting assertions of checks on regulatory and adjudicatory powers as between host and home countries. Again, this indicates the possibility of achieving efficiency gains through harmonization via international law.

B. Optimizing Choice of Law and Procedural Multinational Enterprise Liability Regimes

MNE liability regimes are arrangements that allocate economic and political risks associated with MNE host country activities through a combination of substantive liability rules, choice of law, and procedural regulations. All these legal structures are part and parcel of an interrelated package that seeks properly to limit liability for MNEs as well as their exposure to host country laws and courts. Choice of law and procedural rules are, thus, as much a function of ISE as substantive liability rules. The efficient allocation of economic and political risks between the MNE and the home country on

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168 See supra note 3 and accompanying text.
169 One commentator contends that the Bhopal decision in the United States was undesirable because it did not include the alleged inadequacy (inefficiency) of Indian liability law likely to be applied by Indian courts. See Note, supra note 154, at 244-51. The author maintains that the suboptimal leniency of foreign liability laws should be taken into account when deciding whether to try a case against a U.S. MNE parent in the United States. Id. The author's argument is correct from the standpoint of ISE, if the foreign liability law is the product of a failure in the MNE/host country market.
one side and the host country and the host country creditors on the other calls for a basically congruent construction of substantive MNE liability law, choice of law, and procedural law. MNE liability for host country activities is efficiently restricted to the subsidiary and three categories of parent liability exceptions. These cases are, in principle, efficiently regulated and adjudicated by the host country.

Optimal choice of law and procedural rules, thus, efficiently build on the substantive MNE liability rules applicable to MNE host country activities. A narrowly supplemented limited liability rule for MNE host country subsidiaries entails an adequate limitation of host country legal powers, too. This restriction might efficiently be checked by limited additional home country safeguards. These safeguards may potentially overshoot and trigger a vicious circle of legal conflicts between home and host countries. This, in turn, favors the harmonization of choice of law and procedural issues in the regulatory market among nations. Treaties covering legal assistance, judgment enforcement, choice of law, and jurisdiction do, therefore, have a particular efficiency potential. Unlike substantive liability law, these areas are also less intertwined with other parts of national legal systems. They lend themselves well to international standardization without prohibitive side effects.

Choice of law and procedural issues associated with the legal control of MNE activities in host countries have characteristics favoring flexible solutions in the MNE/host country and the MNE creditor markets. This is due to the dynamic factors determining regulatory and adjudicatory advantages. These factors mandate that choice of law and procedural questions remain subject to amendment on a case-by-case basis where the absence of significant third party interests allows such.

V. Conclusion

The problem of MNE parent liability is multilayered. It consists of substantive law, choice of law, and procedural levels. An internationally efficient approach to these layers requires a matrix optimizing the allocation of economic and political, including legal, powers and risks among home countries and MNEs on one side and host countries and host country creditors on the other.

171 See supra note 70 and accompanying text.
172 They could, e.g., do away with such seemingly exotic devices as the German "Vermögensgerichtsstand" or Art. 59 of the Swiss Constitution, or they could help streamline unpredictable choice of law rules, as they arguably exist in U.S. law.
173 It is, therefore, not surprising that these areas are already broadly covered with various bilateral or multilateral treaties (e.g., Hague treaties, Brussels Convention and Lugano Convention among European Countries).
This global efficiency equation reveals a common function of limited liability, the restricted application of host country law and the limited reach of host country jurisdiction. Further, these devices can be seen as proper vehicles to limit and internalize the risks emanating from the use of political powers by host countries. Limited corporate liability is a plausible second best solution to internalize political risks on a general level. The limited application of substantive host country liability law and the limited reach of host country procedural powers are more specific means to curb the political risks associated with liability legislation and adjudication.

MNE liability regimes are set through an interwoven network of four key players: the MNE and the home country on one side and the host country and the host country creditors on the other. The principal relationship exists between the MNE and the host country. These two, acting in their own interest and as agents for the home country and the host country creditors, respectively, negotiate the liability terms to be applied to the MNE's host country activities. The MNE/host country market is supplemented by the MNE/creditor markets and the regulatory market among nations. Both have the potential to correct some of the imperfections in the MNE/host country market.

The MNE/host country market and its supplementary mechanisms are assumed ultimately to push MNE liability regimes toward ISE. These market mechanisms tend to charge a premium to those actors who defy efficient MNE liability solutions. This is particularly important to host countries. Their discretion in the use of legal powers over MNE host country activities entails a substantial potential for opportunism and inefficiency in general. Inefficient MNE liability laws or judgments can, therefore, be expected to have drawbacks for the respective countries.

If, for example, an ultimate judgment by the Indian courts in the Bhopal case had established a parent liability rule in defiance of the justified expectations of Union Carbide, this might have had far-reaching negative implications. MNEs could have reacted to the lost trust in the Indian adherence to legal principles by diminishing their Indian investments to suboptimal levels. This would have hurt both India's long term interests and ISE.

Another example illustrating this proposition is the Deltec decision. In this case the Supreme Court of Argentina enunciated a sweeping parent liability doctrine. The Court appeared to subscribe to a flat disregard of the limited liability principle for MNE subsidiary-

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175 This explains the efficiency advantages of subsidiary corporations over their principle alternative: branch structures.
1990] Multinational Enterprise Parent Liability

ies.177 This was evidently beyond anything that could reasonably be expected by MNEs in Argentina.178 Partly due to this decision, perhaps, new foreign investment in Argentina came to a temporary standstill.179 The Supreme Court of Argentina later retreated from its ruling180 and enacted a new Code providing for much narrower parent liability rules.181 Deltec highlights the role of host country law as a contract of adhesion between the MNE and its host country. It indicates the commitment of a host country to adhere to the terms agreed upon in the MNE/host country market. Such an agreement might be entirely implicit and consist of the following: An acceptance by the MNE of existing host country substantive law, including the principle of limited liability for subsidiaries and all liability laws applicable to the parent (e.g., piercing laws, de facto director laws, concern laws, tort laws, or fraudulent conveyance laws); an acceptance by the MNE of the host country’s choice of law and procedural rules, subjecting subsidiary and parent to host country rule and jurisdiction in the respective areas; an acceptance by the MNE of subsequent amendments to and interpretations of host country law, such amendments and interpretations to be carried out within the boundaries of applicable international law (e.g., investment treaties), the host country constitution, and other pertinent host country laws; and an acceptance by the host country of the “baggage”182 imposed on the MNE by its home country, like judgment enforcement restrictions, or the right of the home country to retaliate against breaches of the MNE/host country accord by host countries.183

This arrangement between the MNE and its host country binds both sides equally. A host country will, therefore, not be able to amend or interpret existing laws without respecting the procedural or substantive constraints that were implicitly or explicitly negotiated with the MNE. If it did ignore its commitments unilaterally it would

178 See Blumberg I, supra note 32, at 660-69.
179 The drop in foreign investment was a consequence of general nationalist tendencies in Argentina in the beginning of the 1970s and the rebirth of Peronism. The Deltec decision, however, did likely play its part in the hostile reactions of MNEs to the Argentine investment climate at the time. Bruchou, Foreign Investment in Argentina: A Comparative Analysis with the Andean Code 7-9 (1985) (unpublished paper at Harvard Law School Library). See Pardinas, supra note 74, at 59-43.
181 See Pardinas, supra note 74, 43-48.
182 Where such acceptance can not be construed, e.g., because the host country itself has conflicting rules in force, a battle of forms situation results that bears a high potential for future conflict and favors solution through international harmonization.
183 The “Calvo” doctrine as espoused by some Latin American countries reflects an attempt by host countries to demand from MNEs that they waive some of this baggage as a condition to investing in the respective countries. See D. Shea, The Calvo Clause (1955); Shihata, Depoliticization, supra note 19, at 1-3.
result in a breach of contract. Breaches of contract are basically not efficient even where the terms originally agreed upon might have been suboptimal.\footnote{Efficient breaches of contract are the exception, certainly not the rule, and would have to be justified accordingly. See Polinsky, supra note 31, at 29-32.}

Hence, MNE liability regimes are by no means a phenomenon in open space. The formal sovereignty of host countries notwithstanding, MNE liability arrangements are not freely manipulable by host country institutions. Liability regimes are products of world market mechanisms. They are established through explicit or implicit negotiation processes. Once set they represent a dynamic equilibrium. The opportunistic disturbance of this equilibrium can cause inefficiencies like any other breach of contract.\footnote{In these restrictions by world markets and international commitments lies a good deal of the often mentioned, sometimes lamented, loss of de facto sovereignty of host countries vis-a-vis MNEs. See R. Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises 95-96 (1971); Rubin, Multinational Enterprise and National Sovereignty: A Sceptic's Analysis, 3 Law & Pol'y Int'l Bus. 1 (1971); Baum, The Global Corporation: An American Challenge to the Nation State, 55 Iowa L. Rev. 410 (1969) (review of the problem of American-based enterprises penetrating, dominating, and conquering foreign economies from a Canadian and French perspective); Grossfeld, Multinationale Unternehmen und Nationale Souveraenitaet, 18 Juristische Schulung 73 (1978).}

For host country legislators and courts this means that they must differentiate between the situation before a MNE host country investment and the situation after approval of an MNE host country investment. The constraints upon a host country in the first situation are those of the world markets and possibly of international law. The host country is faced with the problem of finding the market clearing liability regimes that will optimize its expected benefits from MNE investments. In contrast, the constraints upon the host country in the second situation are primarily those of the contract with the MNE. This might mandate a very different course of action by host country courts or legislators if called upon to apply or amend MNE liability laws.\footnote{See Griffin, The Power of Host Countries Over the Multinational: Lifting the Veil in the European Economic Community and the United States, 6 Law & Pol'y Int'l Bus. 375 (1974) (discussing issues arising in extraterritorial jurisdiction proceedings).} A host country's leverage will depend on the terms of the MNE/host country agreement. Of course, the more specific these terms, the less the chance and temptation for suboptimal host country actions and suboptimal MNE, or home country, reactions. This, in turn, indicates the value of clear and predictable MNE liability regimes, be it in the area of substantive liability law, choice of law, or procedure.

In sum, MNE liability regimes represent mixes of host, home country, and international law. They allocate economic and political risk by way of substantive liability law, choice of law, and procedural rules. In an attempt to outline a normative framework for such regimes along ISE I showed that the principle of limited liability for
MNE host country subsidiaries is basically efficient. But the limited liability of subsidiary corporations is efficiently supplemented by three categories of parent liability: abuse of a subsidiary, damaging parent interference with subsidiary affairs, and direct infliction of damages on subsidiary creditors by the parent. All these cases of optimal MNE liability for host country activities are, in principle, best regulated and adjudicated by host countries. To be sure, narrow and specific home country checks, like judgment enforcement restrictions, can, if geared to the suboptimal use of these legal powers by host countries, have additional, positive efficiency effects.