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Parent-Subsidiary Responsibility in the Development of Multinational Enterprises

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Abstract: As a core subject in the current international market economic activities, the parent-subsidiary company not only plays an important role in the development of multinational enterprises themselves, but also plays an important role in the bonding of cooperation between countries. However, the limitations of the traditional corporate law governance model, especially the limited nature of liability, make multinational corporations in the actual operation of many problems. Among them, the issue of responsibility sharing between parent and subsidiary companies is still one of the core issues that need to be continuously focused on at this stage, because the assumption of responsibility by parent and subsidiary companies not only has an important impact on the development of the international market economy, but also pays direct attention to the acquisition of creditor's interests. Through comparative research, historical research, and other research methods, the issue of responsibility-sharing among parent-subsidiary companies of multinational enterprises will be studied. The role of the corporate veil piercing system in responsibility-sharing will be analyzed based on domestic and foreign legislation and judicial experience. The aim is to identify a responsibility-sharing approach that promotes the development of multinational enterprises while safeguarding the interests of creditors.

Keywords: Multinational Enterprises, Parent-subsidiary Companies, Assumption of Responsibility, Piercing the Corporate Veil

1. Introduction

In recent years, the development pattern of Chinese multinational enterprises (MNEs) has gradually shown a trend of diversification. Chinese multinational enterprises are no longer limited to setting up production bases in different countries, but are optimizing the allocation of resources on a global scale. The parent company of a multinational corporation establishes a subsidiary in the host country to carry out the investment behavior, from the legal status point of view, the parent company does not interfere with each other have their own independent legal personality, can independently assume legal responsibility. But from the economic level, due to the parent company closely linked, trade business similar characteristics, making the parent company in the brand, capital, technology and other aspects of the subsidiary has controlling power and decision-making power [1] . In practice, there are instances where parent companies abuse the right to control subsidiaries, resulting in the mixing of property, business, and personnel within the subsidiaries. In such cases, the parent company should bear a certain level of responsibility for the damage caused to creditors in the host

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country by the actions of the foreign subsidiary. In order to protect the interests of creditors and maintain positive international relations and image, China's Company Law has established provisions that require shareholders of limited liability companies to assume unlimited liability in certain circumstances, such as "piercing the corporate veil" systems. In other words, under certain circumstances, it is the shareholders of the company who bear direct responsibility for the obligations and liabilities of the company. Additionally, relevant legislation in China also includes provisions for penalties related to the mingling of personalities of affiliated companies and the liquidation of subsidiaries in bankruptcy [2]. However, in practice, some shareholders and subsidiaries are unable to compensate creditors for their losses even through bankruptcy procedures, which prevents the legislative purpose of the Company Law from being realized. Therefore, it is of institutional and practical significance to discuss the issue of parent-subsidiary liability assumption in the development of Chinese multinational enterprises. This paper comprehensively sorts out and analyzes the problems and challenges of parent companies assuming responsibility for their overseas subsidiaries in Chinese multinational enterprises through the study of relevant cases on parent-subsidiary responsibility assumption problems in multinational enterprises. The aim is to provide a useful reference for sharing parent-subsidiary responsibility in Chinese multinational enterprises.

2. Theoretical Foundations of Parent-subsidiary Corporations in Multinational Enterprises

2.1. Definition of Parent-subsidiary of A Multinational Enterprises

In multinational enterprises, the parent company and subsidiary are relative concepts. The parent company refers to another company that has actual controlling interest in the company, and this controlling interest can be manifested through the ownership of a certain amount of shares (usually more than 50%) or through the signing of a control agreement with another company. The parent company generally possesses strong economic strength and holds decision-making power over major business activities of the subsidiary, such as personnel arrangements and profit distribution. Subsidiaries are typically legal entities established by the parent company, either wholly or partially, in accordance with local laws, in various parts of the world. As the subsidiary company possesses a comprehensive company management system and an independent financial statement system, it enjoys significant independence and flexibility in its business activities. It can autonomously engage in business activities and assume responsibilities and liabilities resulting from the company's actions.

2.2. The Legal Relationship Between the Parent-subsidiary Companies of a Multinational Enterprises and Their Assumption of Responsibility

2.2.1. The Legal Relationship Between Parent-subsidiary of Multinational Enterprises

First of all, the internal economy of parent and subsidiary companies are interconnected. The expansion of multinational enterprises occurs through the establishment of branches, which can take various forms such as subsidiaries, affiliated companies, branches. With the trend of economic globalization, large enterprises in developed countries have started to establish branches in various countries around the world to expand their international market presence and overcome trade barriers. This enables them to engage in cross-border business activities, with the most significant form being the relationship between parent company and subsidiaries. For example, the Shengjia Sewing Machine Company in the United States and the Imperial Chemical Company in the United Kingdom are the pioneers of multinational corporations. Subsidiaries established in the host country are controlled and highly centralized by the headquarters of the MNE [3]. The interest group has a unifying goal-to maximize economic benefits.

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The parent company and the subsidiary operate under the same decision-making and operating mechanism, establishing strong global strategic and economic connections. The parent company possesses a certain level of decision-making authority over the subsidiary' business and exercises varying degrees of control over the subsidiary's board of directors, business operations, and financial matters [4]. Under the management of the parent company, the subsidiary establishes its operating mechanism and shares profits with the parent company. In terms of operation, the subsidiary can be seen as a branch of the parent company.

Second, parent and subsidiary companies are externally legally independent of each other. A parent company is a company that legally controls other companies, and a subsidiary is a company that is legally controlled by other companies. Parent-subsidiary companies are independent legal entities, which can sign contracts with creditors independently and have the ability to assume responsibility independently [5].

2.2.2. Assumption of Responsibility by Parent-subsidiary of Multinational Enterprises

According to Article 14 of the Company Law, the parent and subsidiary companies of a multinational corporation have independent legal personality and bear obligations independently to the outside world [6]. In essence, the relationship between the two can be likened to that between a shareholder and a subsidiary company, with the subsidiary company having legal personality and bearing civil liabilities independently in accordance with the law [4]. If the subsidiary company is unable to pay its debts, a bankruptcy system may be applied. Due to the unpredictable nature of risk, and in order to encourage investment, Chinese multinational enterprises' parent companies are generally not held responsible for the debts of their foreign subsidiaries. At the same time, in order to protect the interests of creditors and avoid the abuse of independent personality by the parent company, the parent company may be held jointly and severally liable for the debts of the subsidiaries in cases where the parent company fails to contribute capital as required or breaches an agreement or covenant. According to Article 11 of the "9th Conference Minutes"[7], if the parent company and its subsidiaries mix their personalities and properties, or become a tool for shareholders to evade debts and taxes, the corporate veil can be "pierced", and the parent company will be jointly and severally liable for the debts.

3. Current Situation and Problems of Parent-Subsidiary Liability Assumption in the Development of Chinese Multinational Enterprises

3.1. Current Situation of Parent-Subsidiary Liability Assumption in the Development of Chinese Multinational Enterprises

3.1.1. Legislative Status

Article 14 of China's Company Law stipulates that a company may set up subsidiaries, which shall have legal personality and bear civil liabilities independently according to law. The limited liability system is also used in the assumption of liability of parent and subsidiary companies. This system separates the liability of the subsidiary from that of other members within the multinational enterprise, especially with the parent company. This provision reduces investment risks and enhances investor motivation. In the course of the rise of multinational corporations, there have been cases where some shareholders and parent companies have abused their rights and taken advantage of the "limited liability" provision to evade debts and liabilities. Since creditors cannot directly demand compensation from the parent company, the "limited liability" system is like a veil separating the responsibilities of the parent company and subsidiaries. In order to protect the interests of creditors, China introduced the "corporate personality denial system" to balance the rights and obligations of

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the parent and subsidiary companies. The "corporate personality denial" system is based on the "limited liability" system of the company, and the two systems promote each other by prohibiting creditors from claiming debts directly from bona fide third parties. This protects the rights and interests of the parent company while also safeguarding the rights and interests of creditors, and reducing the abuse of the parent company's rights and privileges. It protects the rights and interests of the parent company. Besides, it safeguards the rights and interests of creditors and reduces the abuse of the parent company's independent personality.

3.1.2. Judicial status

Generally, the liability of the parent company is separate from that of the subsidiary, and the parent company is not directly liable for the acts or obligations of the subsidiary. The parent company has only limited liability for the acts of the subsidiary. Its control over the subsidiary includes the appointment of board members, approval of the company's major decisions, and planning of strategic direction, among other aspects. Depending on the scope of the business under the jurisdiction of the parent company and the extent of its control, this may impact its potential liability for the acts of the subsidiary. However, in judicial practice, there are cases where the parent company has to bear unlimited joint and several liability for the debts of the subsidiary.

The first situation is when the assets of the parent company are commingled. For example, in the case of Nantong Shengqiang Construction Engineering Company Limited and Jialong Gaoke Industry Company Limited, the Supreme People's Court held that the funds exchanged represented a business practice employed by Rongtou Holding Group for managing the finances of Rongtou Guarantee Company. Therefore, Rongtou Holding Group could not be deemed to have commingled assets with Rongtou Guarantee Company. Clearly, Chinese company law refers to two types of property commingling. The first type pertains to the commingling of business premises, primary office equipment, and financial aspects of the company, which can seriously impact the basis of the company's external debt settlement. The second type involves organizational commingling, which occurs when shareholders, directors, responsible persons, and other personnel from related companies are involved. This situation can result in subsidiaries being unable to act independently in the interests of the company, thereby losing the basis of independent liability.

The second situation occurs when the parent company abuses the subsidiary's independent legal person status and limited liability of shareholders. For example, in the loan contract dispute case between Jiafeng Agricultural Capital Company and Zhongnong Group Company , the court found that the group company had abused the independent legal person status and limited liability of the subsidiary's shareholders. Therefore, the parent company should be jointly and severally liable for the subsidiary's debts.

The third scenario is when the parent company's actions amount to assuming the subsidiary's debt. According to Article 552 of the Civil Code, if the parent company clearly indicates its assumption of debt and the creditor dose not explicitly rejected it, the creditor may demand that both the parent and subsidiary companies be jointly liable for the debt.

3.2. Problems in the Assumption of Responsibility by Parent-subsidiary Companies in the Development of Chinese Multinational Enterprises

3.2.1. Parent-subsidiary Liability Sharing Definition Problem

The subsidiary faces a contradiction between its independence legal personality and economic non-independence. Regarding liability issues of China's multinational corporations, the responsibility of subsidiaries within multinational corporations has not been clearly addressed in specific provisions. Usually, regulations such as the Implementation Regulations of the People's Republic of China on

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Foreign Investment Law are used to regulate these issues. However, in many cases, due to the actual control exerted by the parent company over the subsidiary, a significant portion of the responsibility needs to be borne by the parent company. Nevertheless, proponents of a strict limited liability system argue that holding the parent company liable for the subsidiary's obligations undermines the fundamental principle of limited liability and increases risks in the capital market. Therefore, there is a need for the establishment of a comprehensive liability assumption system to address these issues.

3.2.2. Application of Legal Personality Denial in Parent-subsidiary Companies Needs to be Clarified

Firstly, there is the issue of the standard and burden of proof for determining property commingling. In the case of Ying Mou v. Jiameide (Shanghai) Trade Co., Ltd. and other contractual disputes, the court held that the determination of whether a company has engaged in property commingling should be consider factors such as the establishment of an independent and standardized financial system, clear financial transactions, and the presence of an independent place of business. The court will make comprehensive assessments based on these considerations. To determination of whether the parent-subsidiary company has engaged in personality mixing mainly depends on factors such as personnel, business, and property, with property mixing being the main determining factor. However, proving whether a company's financial affairs are mixed is often challenging because it is typically difficult for third parties to access a company's financial information.

Secondly, let's discuss the application of the corporate veil piercing regime. In China, the concept of "significant undercapitalization" is outlined in Jiu Min Ji Yuan. It states that when the actual amount of capital invested by shareholders in a company's operation is significantly deviates from the risks associated with those operation, it is indicative of an attempt to exploit the company's independent legal personality and the limited liability of shareholders, thereby shifting investment risks onto creditors. This practice can seriously infringe upon the interests of minority shareholders, creditors, and even the host country itself. In assessing business risk, the determination should consider of factors such as the amount of money involved in the case, the scale of operations, and the extent of liabilities. When discussing the issue of significant undercapitalization, it is crucial to clearly define the meaning of "capital". For example, does it refer to "registered capital" or should it encompass the "total assets of the company"? At the same time, it is important to focus on the criteria for determining significant undercapitalization. From a positive perspective, it is necessary to identify the risks implied by the company's operations and determine the extent to which there is an "obvious" mismatch. From a negative perspective, it is crucial to establish the relationship between "significant undercapitalization" and "undercapitalization" [8]. On the other hand, it is also necessary to distinguish between "significant undercapitalization" and the normal way of doing business, which may involve "make do with what you have". In situations where there is rapid economic development [9], companies often have a higher risk-bearing capacity. Therefore, judicial practice must pay close attention to differentiating between cases of significant undercapitalization and instances where a company is operating within reasonable limits given its size and resources.

4. Extraterritorial Mirroring of the Liability of a Parent Company to Its Subsidiaries

4.1. The U.S.

4.1.1. The Reverse Piercing of The Corporate Veil Regime

Reverse piercing of the corporate veil originated in Anglo-American jurisprudence. It refers to a situation where, under specific circumstances, creditors of shareholders may seek to hold the company liable for the debts of its shareholders. Unlike traditional piercing of the corporate veil,

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reverse piercing does not involve the abuse of limited liability by shareholders. Furthermore, reverse piercing can be further categorized into insider reverse piercing and outsider reverse piercing [10]. In the United States, the 1957 case of W. G Pratts Corp. v. Pratts was one of the earliest precedents to establish the possibility of reverse piercing of the corporate veil [11]. The significance of the Pratts case is that "fairness" was used as a factor in determining reverse piercing, and it also affirmed that reverse piercing can be used when there are other shareholders in the corporation. The significance of Platts case was that it introduced the factor of "fairness" in determining reverse piercing, and it also acknowledged the possibility of reverse piercing even when other shareholders are present. In comparison to the traditional veil piercing regime, the reverse veil piercing regime reflects the application of insider reverse piercing to preserve higher-ranking rights, ensuring that there is no flow of liability. Conversely, when outsider reverse piercing is applied, liability flows from the shareholders to the corporation. It also reflects the fact that the parent company needs to be jointly and severally liable for the debts of the subsidiary, whereas the shareholders of the company only bear limited liability for the debts. It should be noted that when utilizing this system, due consideration should be given to striking a balance between the necessity of reverse piercing and the potential impact it may have on the interests of bona fide shareholders and creditors of the company. In comparison to the traditional system of piercing the corporate veil, the reverse system aims to protects the interests of shareholders and creditors.

4.1.2. The Standard of Review for Defining Whether a Parent-subsidiary Company is Conflating Personalities

The U.S. Securities Act and the Securities Exchange Act contain substantive provisions on "control" between a parent and a subsidiary. Control is defined as having the power, directly or indirectly, to direct the management of a person, whether through the ownership of voting securities, by contract, or otherwise. On the other hand, The Public Utility Holding Act recognizes parent-subsidiary corporations based on a quantitative criterion: a corporation is considered the parent of another corporation if it owns 10 percent or more of the other corporation's voting stock [12]. The Investment Company Act provides that a corporation that directly or indirectly owns 25 percent of the equity interests in another corporation is presumed to be the controlling corporation, or the parent corporation, while the other corporation is considered the subsidiary. it is worth noting that most state laws in the United States do not provide a specific legal definition of a parent-subsidiary company. In judicial practice, U.S. courts generally define a parent company as one that "holds more than half of its subsidiary's equity and exercises actual control over the subsidiary". However, it should be noted that "hold more than half of the shares" is not an absolute requirement. When determining whether two companies are a parent-subsidiary, courts primarily rely on substantive standards. These standards are used to assess the level of control that the parent company exercises over the subsidiary.

4.2. European Union

4.2.1. Solve the Problem of Burden of Proof - Reversal of the Burden of Proof

In theory, China usually adopts the principle of "who claims, who proves" when it comes to the allocation of the burden of proof. This means that the party making a claim regarding the existence of the right bears the burden of proving the legal elements supporting that right. On the other hand, the party denying the existence of the right bears the burden of preventing or eliminating the legal elements necessary for establishing the right, or limiting the legal effects of those element. This determines which party bears the burden of proof. In practice, asserting joint and several liability based on the doctrine of piercing the corporate veil can be a powerful tool for creditor self-protection. However, it carries significant legal risk and can easily be dismissed if not carefully pursued.

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Additionally, proving the commingling of finances within a company is often challenging, as obtaining the company's financial information from third parties can be difficult. Legal representatives and may abuse the subsidiary's legal personality for personal gain [13]. If the parent company establishes multiple subsidiaries or even grandchildren under limited liability protection, the shareholders of the parent company are insulated from multiple risks, and creditors may have difficulty holding them liable. However, in the event of an EU multinational enterprise violating European Union Competition Regulation, if it can be proved that the EU subsidiary and the parent company belong to a single economic entity, they may be treated as a single enterprise and held jointly and severally liable for any external debts. According to the provisions of the draft EU company law, if the creditors of the subsidiary company wish to establish the existence of "unified management" by the parent company, they only need to provide prima facie evidence such as shareholding, voting rights, the composition of the subsidiary company's management. It is then responsibility of the parent company to bear the burden of proof regarding the "non-existence of unified management" in substance [14]. This concept of " reversal of the burden of proof " is worth considering. Therefore, the reversal of the burden of proof and the requirement for the parent company to provide evidence of legal management and a list of the company's operations contribute to a fair allocation of the burden of proof.

5. Improvement Path of Chinese Parent Company's Responsibility for Overseas Subsidiaries

5.1. Definition of Chinese Parent Company's Responsibility for Overseas Subsidiaries

The definition of responsibility involves the issue of jurisdiction, and the responsibility of Chinese parent companies to overseas subsidiaries needs to be clearly defined in accordance with local laws and regulations, international practices, and industry norms. In the governance of multinational enterprises, the liability of Chinese parent companies to overseas subsidiaries needs to be clearly defined in accordance with local laws and regulations, international practices, and industry norms. At the same time, the legislature also needs to take into account the long-term strategic cooperative relationship between the parent company and its subsidiaries, and make timely adjustments and improvements to the provisions governing the relationship between the parent company and its subsidiaries to ensure synergistic development between them [15].

5.2. Construction of China's Reverse Corporate Veil Piercing System

Compared to the traditional corporate veil piercing system, the reverse system protects the interests of shareholders' creditors instead of corporate creditors. However, when applying the reverse corporate regime, the criteria for its application need to be strictly defined and the social benefits must be measured carefully. This definitive standard requires weighing a number of factors: first, determining whether there is a confusion of identity between the shareholders and the corporation. Second, assessing the extent to which the damage to creditors is connected to the confusion of identity. Only when a direct causal link exists will creditors be entitled to propose the application of the reverse piercing of the corporate veil regime. The degree of fault of the controlling shareholders is measured against the fault of the bondholders themselves. It is only justifiable to hold the corporation liable for the shareholders with its assess if the imbalance of interests primarily arises from the wrongful acts of the corporation and the shareholders. When it becomes necessary to pierce the corporate veil in reverse through an outsider, the availability of other remedies, such as equity enforcement proceedings and avoidance rights, must be considered first. Only when none of the above remedies can provide effective relief to creditors should the remedy of reverse piercing of the corporate veil

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through outsiders be considered. In other words, reverse piercing of the corporate veil should be used as a supporting clause to protect the interests of creditors.

6. Conclusion

Due to the close connection between parent and subsidiary companies, in China's practice, there are some parent companies that abuse their rights to control their subsidiaries and create a phenomenon of mixing property, business, and personnel with their subsidiaries. In this kind of situation, if the parent company causes damage to creditors in the host country of its foreign subsidiaries, it should bear certain responsibilities. However, the extent of responsibility and whether it should be attributed are unclear, along with other issues. This paper aims to address these concerns by clarifying the role of Chinese parent company in managing overseas subsidiaries. Drawing on domestic and international theories and practice models, it proposes a comprehensive approach to defining parent-subsidiary responsibility and establishing a reverse piercing of the corporate veil system. This research provides a valuable reference for the sustainable development of multinational enterprises. Further studies are needed to explore the regulatory system of multinational enterprises, considering the time and theories accumulated.

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